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# Petition and Transcript of Record

## Supreme Court of the United States

OCTOBER TERM, ~~1929~~ 1930

**No. ~~625~~ 40**

FAWCUS MACHINE COMPANY, PETITIONER,

*vs.*

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

PETITION FOR CERTIORARI FILED FEBRUARY 4, 1930

CERTIORARI GRANTED APRIL 21, 1930

**(34,756)**

# (34,756)

# SUPREME COURT OF THE UNITED STATES

## OCTOBER TERM, 1929

# No. 625

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FAWCUS MACHINE COMPANY, PETITIONER,

*vs.*

THE UNITED STATES

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ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., FEBRUARY 5, 1930

IN THE

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1929

No. 625

FAWCUS MACHINE COMPANY, a Corporation, Petitioner,

v.

THE UNITED STATES OF AMERICA

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS AND BRIEF IN SUPPORT THEREOF

## Petition

The Fawcus Machine Company, by James S. Y. Ivins, its attorney, prays that a writ of certiorari issue to review the judgment of the Court of Claims entered on November 4, 1929, dismissing the petition of said Fawcus Machine Company.

## Question Presented

In the determination of petitioner's excess profits taxes for the calendar year 1919, should its invested capital be reduced by the amount of Federal income and excess profits taxes for the year 1918 as determined and assessed under the Revenue Act of 1918, which was a retroactive statute enacted on February 24, 1919? In other words: can a tax accrue as a liability before the enactment of the statute imposing it?

## The Statute and Regulations Involved

Revenue Act of 1918, Section 326:

"(A). That as used in this title the term 'invested capital' for any year means (except as provided in subdivisions (b) and (c) of this section):

"(1) Actual cash bona fide paid in for stock or shares:

"(2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, * * *;

"(3) Paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year. * * *

"(d) The invested capital for any period shall be the average invested capital for such period * * *."

Regulations 45, Article 845:

"Surplus and Undivided Profits; Reserve for Income and Excess Profits Taxes.—For the purpose of computing invested capital federal income and war profits and excess profits taxes are deemed to have been paid out of the net income of the taxable year for which they are levied. It is immaterial, therefore, whether reserves for the payment of such taxes for the preceding year have been set up or not, or if set up whether such taxes when paid have actually been charged against such reserves. Amounts payable on account of such taxes for the preceding year may be included in the computation of invested capital only until such taxes become due and payable. A deduction from the invested capital as of the beginning of the taxable year must therefore be made for such taxes or any installment thereof, averaged for the proportionate part of the taxable year after the date when the tax or the installment is due and payable. Where as a result of an audit by the Commissioner, or the acceptance of an amended return, or for any other reason, the amount of any such tax for the preceding year is subsequently changed, a corresponding adjustment will be made in the invested capital for the taxable year upon the same basis as if the corrected amount of the tax for the preceding year had been used in the original computation of the invested capital for the taxable year. See articles 1541 and 1542."

Revenue Act of 1926, Section 1207:

"The computation of invested capital for any taxable year under the Revenue Act of 1917, the Revenue Act of 1918, and the Revenue Act of 1921, shall be considered as having been correctly made, so far as relating to the inclusion in invested capital for such year of income, war-profits, or excess-profits taxes for the preceding year, if made in accordance with the regulations in force in re-

spect of such taxable year applicable to the relationship between invested capital of one year and taxes for the preceding year."

Statement.

This case was instituted by the petitioner in the Court of Claims to recover excess profits taxes for the year 1919 alleged to have been overpaid. The Court of Claims, after finding the facts in accordance with a stipulation by the parties, dismissed the petition with the following memorandum:

"This case falls within the decision of the Supreme Court in the case of United States v. Yale & Towne Mfg. Co., 269 U. S. 422, and the following citations, viz: Nichols v. Sylvester Co., 16 Fed. (2d) 98; Bowers v. Kaufmann & Co., 18 Fed. (2d) 69; Russel Wheel and Foundry Company, 3 B. T. A. 1168. The petition is dismissed. It is so ordered."

The petitioner in March, 1920, filed its income and profits tax return for the calendar year 1919 (R. 25 ¶ II) and subsequently filed amended returns. The total amount originally paid (in various installments) was $43,119.26 (R. 25 ¶ II). The Commissioner of Internal Revenue determined the petitioner's liability for taxes for 1919 to be $41,182.77. The difference was refunded (R. 25 ¶ III). The petitioner claims that the further sum of $1,597.85 should have been refunded on the ground that the Commissioner erroneously reduced petitioner's invested capital for 1919 below the correct amount allowable under the statute.

Under the provisions of the Revenue Act of 1918, more particularly Section 326 thereof, the invested capital of a corporation includes cash and property (subject to certain limitations) paid in for stock, and paid-in or earned surplus and undivided profits, not including surplus and undivided profits earned during the year. The total taxes due from plaintiff for the year 1918 amounted to $78,784.95, which were paid in four equal installments on or about the 15th days of March, June, September, and December, 1919. Under the regulations then in force in respect of such taxable year applicable to the relationship between invested capital of one year and taxes of the preceding year the

amount of such taxes was included by the Commissioner of Internal Revenue in the invested capital of the plaintiff for the year 1919 only until the installments were actually paid, the balance being excluded. This was accomplished by determining the average deduction for the year and reducing the earned surplus on January 1, 1919, by that amount. The amount of the average deduction was $33,294.68.

During the taxable year 1919, at the time each installment of 1918 income and profits taxes of the plaintiff became due and payable, the plaintiff had on hand surplus or undivided profits, earned during the taxable year 1919, more than sufficient to pay such installment (R. 26 ¶ V).

Petitioner claims that its earned surplus for 1919 should not have been thus reduced and that the difference in taxes attributable to such erroneous reduction should be refunded.

## Specification of Errors to be Urged

The Court of Claims erred in holding that the plaintiff was not entitled to recover and that the petition should be dismissed. The decision of the Court of Claims amounted to a ruling that the Commissioner of Internal Revenue acted correctly in reducing the petitioner's 1919 invested capital by the amount of its 1918 income taxes prorated from dates of payment.

## Reasons for Granting the Writ.

The Court of Claims dismissed the petition before it in a summary manner, without any attempt to answer the plaintiff's contention that a tax cannot accrue as a liability prior to the enactment of the statute imposing it. On its face the decision of the Court of Claims was based upon four cases none of which involved this controlling point.

The decision of the Court of Claims is in conflict with the decisions of the Supreme Court in United States v. Woodward, 256 U. S. 632; Town of Koshkonong v. Burton, 104 U. S. 668, and other cases.

The Court of Claims in dismissing the petition below, has, it is believed, placed an improper construction on Section 326 (a) of the Revenue Act of 1918, or on Section 1207 of the Revenue Act of 1926. The decision of the Court of

Claims is being followed by the Bureau of Internal Revenue in closing all pending excess profits tax cases. A large number of such cases for the year 1919, including those of many of the largest oil companies, are still pending in the Bureau of Internal Revenue, before the Board of Tax Appeals and before the District Courts and Circuit Courts of Appeals, and in practically every one of them the question in this case is necessarily involved in a correct computation of the disputed taxes. In a large number of such cases the taxpayer's rights under this point have been saved and in many others such rights may still be saved, so that if the Supreme Court should reverse the Court of Claims, it will be possible for such taxpayers to have the decision of the Supreme Court applied in the computation of their taxes.

Wherefore it is respectfully submitted that this petition for writ of certiorari to review the judgment of the Court of Claims should be granted.

J. S. Y. Ivins, Attorney for Petitioner. c/o Holmes, Brewster & Ivins, 815 Fifteenth Street N. W., Washington, D. C.

February, 1930.

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[fols. a & 1] IN THE COURT OF CLAIMS

No. H 250

FAWCUS MACHINE COMPANY, a Corporation, Plaintiff,

against

THE UNITED STATES OF AMERICA, Defendant

1. PETITION—Filed June 14, 1927

To the Honorable the Court of Claims:

The above-named plaintiff, by Holmes, Brewster, & Ivins, its attorneys, respectfully shows:

First. The plaintiff is and at all times hereinafter mentioned was a corporation duly organized and existing under the laws of the State of Pennsylvania, now having its office and principal place of business at 2818 Smallman Street, Pittsburgh.

Second. The plaintiff has a just claim against the United States of America in the amount of $1,597.85, with interest thereon from March 15, 1920, which said claim arises in connection with the payment by the plaintiff of excess profits tax for the year 1919 as hereinafter more fully set forth.

Third. On or about the 15th day of March, 1920, pursuant to the Revenue Act of 1918, the plaintiff filed with [fol. 2] the then duly appointed, qualified and acting Collector of Internal Revenue for the 23d District of Pennsylvania, on Form 1120, its income and profits tax return for the taxable year ended December 31, 1919, accompanied by its Government contracts, profits, tax return for the same period on Form 1120-S, and subsequent thereto in June, 1921, and in January, 1922, the plaintiff filed in the same manner amended income and profits tax returns and Government contract profits tax returns for the taxable year ended December 31, 1919. The plaintiff paid tax thereon as follows: $30,328.81 in four equal installments on or about the 15th days of March, June, September and December, 1920, respectively; $4,558.94 in or about June, 1921 (accompanying first amended returns); $8,231.51 in or about January, 1922 (accompanying second amended returns); a total tax payment for the taxable year 1919 of $43,119.26.

Fourth. The Commissioner of Internal Revenue in a letter dated May 13, 1924 (copy of which is hereto annexed, marked Exhibit A, and made a part of this petition) determined the liability of the plaintiff for income and profits taxes for the taxable year 1919 to be $41,182.77. Thereafter, by his Certificate No. 673829, the Commissioner of Internal Revenue, pursuant to such determination, certified an over-assessment of $1,936.49, which amount was subsequently refunded to the plaintiff by the Collector of Internal Revenue with interest amounting to $269.07.

Fifth. Under the provisions of the Revenue Act of 1918, more particularly Section 326 thereof, the invested capital [fol. 3] of a corporation includes cash and property (subject to certain limitations) paid in for stock and paid-in or earned surplus and undivided profits, not including surplus and undivided profits earned during the year. The Com-

missioner of Internal Revenue in making his said determination reduced the petitioner's earned surplus at the beginning of the year by $33,294.68, as shown in Schedule 4 of the Commissioner's said letter (Exhibit A annexed), such reduction being on account of income and profits taxes determined by him to have been due from the plaintiff for the taxable year 1918 and payable during the taxable year 1919. Such reduction of invested capital was improper under the provisions of the Revenue Act of 1918 for the reason that such taxes for the year 1918 had not and could not have accrued during the taxable year 1918, and had not and could not have been a charge against the income of the petitioner for the year 1918. During the taxable year 1919, at the time each installment of 1918 income and profits taxes of the plaintiff became due and payable, the plaintiff had on hand surplus or undivided profits, earned during the taxable year 1919, more than sufficient to pay such installment.

Sixth. The computation of income and profits taxes of the plaintiff for the taxable year 1919 made in the Commissioner's said determination was further incorrect in the adjustment for 1917 taxes contained in Item (e) of Schedule 3, and explained in Item (e) of Schedule 4 of the Commissioner's said letter of May 13, 1924 (Exhibit A), in that the 1917 taxes, shown by said letter to have amounted to [fol 4] $94,370.96, had been erroneously computed in the same manner that the 1919 taxes were erroneously computed as alleged above, that is, through reducing the invested capital of the plaintiff for the taxable year by the amount of income taxes for the preceding year prorated from due date. In this manner, the 1917 taxes, by which the Commissioner reduced surplus in computing invested capital of the plaintiff, were overstated to the extent of $339.58.

Seventh. A proper computation of the plaintiff's income and profits taxes for 1919 indicates a tax of $39,584.92 instead of the tax of $41,182.77, determined by the Commissioner of Internal Revenue in said letter.

Eighth. Through mistake, error and inadvertence, the plaintiff paid in excess of all refunds heretofore made to it on account of 1919 taxes, the sum of $1,597.85 in excess of the taxes lawfully due and payable by it.

Ninth. That thereafter, on or about December 9, 1925, the plaintiff duly filed, with the Collector of Internal Revenue for the 23d District of Pennsylvania for transmission to the Commissioner of Internal Revenue, a claim (a copy of which is hereto annexed marked Exhibit B, and made a part of this petition) for refund of said excess tax in the amount of $1,597.85, paid as aforesaid, on the ground that the plaintiff's invested capital for the taxable year 1919, as finally adjusted in the Commissioner's letter of May 13, 1924, had been erroneously reduced by the amount of $33,294.68.

[fol. 5] Tenth. On or about December 21, 1925, the Commissioner of Internal Revenue, by a letter (a copy of which is hereto annexed, marked Exhibit C and made a part of this petition) rejected said claim for refund.

Eleventh. Under said claim for refund the plaintiff was entitled, in accordance with the provisions of Section 281 of the Revenue Act of 1924, to a refund of the excess tax amounting to $1,597.85, paid by it as aforesaid, and the rejection of said claim by the Commissioner of Internal Revenue, as aforesaid, was wrongful, illegal and unlawful.

Twelfth. That the United States of America is now wrongfully and unlawfully withholding and retaining from the plaintiff, without it- consent and against its will, the whole of said amount of $1,597.85.

Thirteenth. On February 5, 1926, the plaintiff filed in this Court a petition setting forth the foregoing facts and seeking judgment against the United States in the sum of $1,597.85, with interest and costs. In February, 1927, the attorney for the defendant moved that said case be dismissed for lack of prosecution because of failure to hear from clients on matters essential to the prosecution of such case. The attorneys indorsed "No objection" on said motion and it was granted on February 14, 1927. Such dismissal was not upon the merits, which were never considered by the Court.

Fourteenth. The plaintiff is and always has been the sole owner of the claim herein referred to and has not assigned [fol. 6] or transferred the whole or any part thereof or interest therein. It has at all times borne true allegiance to the Government of the United States and has not in any

way aided, abetted or given encouragement to rebellion against the said Government. It believes the facts as stated herein to be true and that it is justly entitled to the amount claimed from the United States after allowing all just credits and off-sets.

Wherefore, the premises considered, the plaintiff prays for judgment against the United States of America in the sum of $1,597.85, with interest thereon from the fifteenth day of March, 1920, and its costs herein.

Fawcus Machine Company, by Holmes, Brewster & Ivins, Attorneys for Plaintiff, 815 Fifteenth Street N. W., Washington, D. C.

*Duly sworn to by James S. Y. Ivins. Jurat omitted in printing.*

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[fol. 7] EXHIBIT A TO PETITION

Copy

Treasury Department, Washington

May 13, 1924.

IT:CR:A. AH.

Fawcus Machine Company, 1606 First National Bank Building, Pittsburgh, Pennsylvania.

SIRS: An examination of your income tax return together with the information heretofore submitted has been made, and the results thereof are outlined in the attached schedules.

In accordance with the provisions of Section 250 (d) of the Revenue Act of 1921, you are granted thirty days within which to file an appeal and to show cause or reason why this tax or deficiency should not be paid. The appeal, if filed, must be addressed to the Commissioner of Internal Revenue, Washington, D. C., for the specific attention of IT:CR:A-AH.

Treasury Decision No. 3492, setting forth the privileges of taxpayers in cases of appeal, is attached for your information and guidance.

Where a taxpayer has been given an opportunity to appeal and has not done so, as set forth above, and an assessment has been made, or where a taxpayer has appealed and an assessment in accordance with the final decision on such appeal has been made, no claim in abatement of the assessment will be entertained. This assessment is in addition to all other outstanding and unpaid assessments appearing upon the Collector's lists.

Payment should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

Respectfully, J. G. Bright, Deputy Commissioner, by L. T. Lohmann, Head of Division.

Inclosure: T. D. 3492, Schedules 1 to 10, inc., Statement.

[fol. 8] Copy

IT:CR:A. AH.

Statement of Returns Examined and Resulting Tax Liability

| Company. | Year. | Form. |
|---|---|---|
| Fawcus Machine Company | 1919 | 1120 |

Resulting Tax Liability

| Name of Company. | Year. | Over-assessment. |
|---|---|---|
| Fawcus Machine Company | 1919 | $1,936.49 |

Bureau letter dated October 29, 1923, has been made the basis of the adjustments which are fully explained in the attached Schedules 1 to 10, inclusive.

The adjustments contained in the accompanying schedules are in accordance with the agreement reached in the conference held November 16, 1923, the income of $162,089.19, as adjusted by the Revenue Agent being accepted as the correct net income for the taxable year.

A Certificate of Overassessment will be issued through the office of the Collector of Internal Revenue for your district, and will be applied by that official in accordance with the provisions of Section 252 of the Revenue Act of 1921.

[fol. 9] Copy

Fawcus Machine Company

Year ended December 31, 1919

Schedule 1

Net Income

| | | |
|---|---|---|
| Net income as disclosed by Bureau letter dated October 29, 1923 | | $168,511 71 |
| As corrected | | 162,089 19 |
| Net deductions | | $6,422 52 |
| Additions | | |
| (a) Depreciation account Residual Value | $12,485 17 | |
| (b) Error in Bureau letter dated 9/11/23 | 02 | |
| Total additions | | 12,485 19 |
| (b) Deductions: | | |
| (c) Depreciation disallowed in Bureau letter dated October 29, 1923 | $18,907.71 | |
| Total Deductions | | 18,907 71 |
| Net deductions as above | | $6,422.52 |

Schedule 2

Explanation of Items Changed

(a) In accordance with the agrement reached in the reference held November 16, 1923, the income of $162,089.19 as corrected by the Revenue Agent is used as the correct income. This by way of compromise only, since it has been shown that additional depreciation should be allowed on costs that had been restored to the property accounts and it was also conceded that depreciation should be disallowed on costs used as a basis for amortization allowed for 1918. [fol. 10] Accordingly, the adjustment (a) and (c) repre-

sent respectively, the restoration to income of the depreciation that has been allowed on the Residual Value of amortized costs, and the disallowance from income of the depreciation that had been restored to income in Bureau letter dated October 29, 1923.

(b) This is necessary to correct as error in computation contained in Bureau letter dated September 1, 1923, namely, the difference between $95,259.26 and $72,555.42 should be shown as $22,703.82 instead of $22,703.74.

Schedule

Consolidated Invested Capital 1919

| | | |
|---|---|---|
| As reported on Bureau letter dated October 29, 1923 | | $738,592 17 |
| As corrected | | 736,470 52 |
| Net decrease as explained below | | $2,031 65 |
| Increases: | | |
| (a) 1918 Income Taxes adjusted | $6,586 52 | |
| (b) Amortization Adjustment .. | 40,866 48 | |
| (c) Inadmissible Deduction | 31 78 | |
| Total increase .. | | $47,484 78 |
| Decreases: | | |
| (d) Appreciation adjusted | $1,783 73 | |
| (e) Adjustment for 1917 taxes | 28,824 99 | |
| (f) Depreciation adjustment | 18,907 71 | |
| Total decrease .. | | 49,516 43 |
| Net decrease as above | | $2,031 65 |

[fol. 11] Schedule 4

Explanation of Items Changed

(a) 1918 Income Taxes Adjusted:

Under Section 250, Revenue Act of 1918, income and profits taxes may be paid in quarterly installments. The

first installment becomes due and payable at the time fixed by law for filing the returns and the second, third and fourth on the 15th day of the third, sixth and ninth months, respectively, thereafter. Treasury Decision 2791 provides that amounts payable on account of such taxes may be included in invested capital only until due and payable. The taxes, therefore, are adjusted as follows:

| First Installment | Second Installment | Third Installment | Fourth Installment |
|---|---|---|---|
| 292/365 | plus 200/365 | plus 108/365 | plus 17/365-617/365 |

617/365 divided by 4 (the number of installments) equals .4226027.

| | |
|---|---|
| $78,784.95 multiplied by .4226027 equals the adjusted average for the year which is | $33,294 68 |
| Deducted in Bureau letter dated October 29, 1923 | 39,881 20 |
| Difference to be restored | $6,586 52 |

(b) Amortization:

Invested capital should be increased by the amount of disallowed amortization that had not been restored upon your books.

| | |
|---|---|
| Total to be restored | $41,741 72 |
| Restored upon your books | 875 24 |
| Balance to be restored | $40,866 48 |

[fol. 12] (c) Inadmissible Adjustment:

| | |
|---|---|
| Percentage deduction shown in Bureau letter dated 9/11/23 | 000344 |
| Invested capital before inadmissible deduction | $736,723.95 |
| Deduction .03447 of $736,725.95 | $253 43 |
| Deduction in office letter dated Oct. 29, 1923 | 285 21 |
| Difference to be restored | $31 78 |

(d) Appreciation Adjusted:

| | |
|---|---|
| Appreciation correctly deducted from invested capital in office letter dated September 11, 1923 | $75,965.95 |
| Appreciation deducted in office letter dated October 29, 1923 | 74,182 22 |
| Balance to be deducted | $1,783 73 |

(e) Adjustment for 1917 taxes:

The correct amount of 1917 income and profits taxes that are considered to have — due and payable on June 15, 1918, should be deducted from invested capital.

| | |
|---|---|
| Corrected tax liability shown in Bureau letter dated 3 9 23 | $94,370 96 |
| Amount charged to surplus prior to 1/1/1919 | 74,873 24 |
| Balance to be deducted from invested capital | $19,497 72 |
| Increase in Invested Capital Bureau letter dated 9/11/23 | 9,327 27 |
| Total to be deducted from invested capital | $28,824 99 |

[fol. 13] (f) Depreciation Adjustment:

Adjustment is made to invested capital for depreciation that has been allowed as a deduction.

| | |
|---|---|
| As restored in office letter dated Sept. 11, 1923 | $ 30,11643 |
| Amount deducted in office letter dated Oct. 29, 1923 | 11,208.72 |
| Balance to be deducted | $ 18,907.71 |

## Schedule 5

### Proof of Invested Capital

| | | |
|---|---|---|
| Capital Stock | | $283,984.35 |
| Surplus as corrected (Schedule 6) | | 415,682.07 |
| Reserves for Dividends | | 15,706.32 |
| Reserves for Taxes | | 65,220.80 |
| Total, corrected balance sheet beginning of year | | $780,593.54 |
| Addition — Capital Stock sold — 1/18/19— $5,178.88 prorated | | 4,957.67 |
| Total | | $785,531.21 |
| Reductions: | | |
| 1918 Taxes prorated | $33,294.68 | |
| Dividend paid, prorated | 15,512.58 | |
| Inadmissible deduction | 253.43 | |
| Total (deduct from above) | | 49,060.69 |
| As shown on Schedule 3 | | $736,470.57 |

[fol. 14]

## Schedule 6

### Analysis of Corrected Surplus

| | | |
|---|---|---|
| Surplus as shown by Revenue Agent | | $421,974.80 |
| Add: Depreciation restored | | 73,076.62 |
| Total | | $495,051.42 |
| Less: | | |
| Appreciation deducted by Revenue Agent | $63,350.29 | |
| Appreciation to be deducted | 75,965.95 | |
| Difference to be deducted | $12,615.56 | |
| Amortization allowed $48,131.31 | | |
| Allowed by Agent 875.24 | | |
| Balance to be deducted | 47,256.07 | |
| Additional 1917 taxes set up as a liability | 19,497.72 | |
| Total (deduct from above) | | $ 79,369.35 |
| Corrected surplus (as shown on Schedule 5) | | $415,682.07 |

## Schedule 7

### Computation of Excess Profits and War Profits Credits

| | |
|---|---|
| Net income taxable year (Schedule 1) | $162,089.19 |
| Net income prewar period shown in R. A. R. | 12,818.18 |
| Invested capital taxable year (Schedule 3) | $736,470.52 |
| Invested capital prewar period shown in R. A. R | 203,501.13 |
| Increase in invested capital for taxable year as compared with average for prewar period | $532,969.39 |

[fol. 15]

### Excess Profits Credit

| | |
|---|---|
| 8% of invested capital for taxable year | $ 58,917.64 |
| Exemption | 3,000.00 |
| Excess profits credit | $ 61,917.64 |

### War Profits Credit

| | |
|---|---|
| Average net income for prewar period | $ 12,818.18 |
| Plus 10% of increase in invested capital as compared with average for prewar period | 53,296.94 |
| 10% of invested capital for taxable year | $ 73,647.05 |
| Exemption | 3,000.00 |
| War Profits credit | $ 78,647.05 |

## Schedule 8

### Adjustment Account Government Contracts

| | |
|---|---|
| Amount of Government contracts | $226,302.50 |
| Gross income from contracts | 50,245.39 |
| Total Gross income 1919 (Line A-11 of return) | $367.178.58 |
| Add: | |
| Miscellaneous claims and allowances | 387.98 |
| Sale of capital assets | 3,135.04 |
| Total Gross Income | $370,701.60 |

| | |
|---|---|
| Less: Dividends received | 21.60 |
| Net Gross Income | $370,680.00 |
| Percentage that gross income from contracts is of the total gross income | .13555 |
| Total general expenses (Lines A-20 and A-25 of return) | $212,977.31 |
| Less: Depreciation disallowed | 4,364.90 |
| Net General Expenses | $208,612.41 |
| [fol. 16] Gross income from Government Contracts (above) | $ 50,245.69 |
| Less expenses applicable to Government Contracts (13.555% of $208,612.41) | 28,277.41 |
| Net income from Government Contracts | $ 21,968.28 |
| Total Net Income (Schedule 1) | $162,089.19 |
| Percentage that Net Income from Government Contracts is of the Total Net Income | 13.55 |
| Percentage that other income is to the total income | 86.45 |

Schedule 9

Computation of Total Tax (1918) Rates for Government Contracts

| Excess Profits Tax | Income | Tax |
|---|---|---|
| Net income for taxable year | $162,089.19 | |
| Less excess profits credit | 61,917.64 | |
| Balance | $100,171.55 | |
| Taxable at 30% | $85,376.46 | $25,612.94 |
| Taxable at 65% | 14,795.09 | 9,616.81 |
| | $100,171.55 | $35,229.75 |
| War Profits Tax: | | |
| Net income for taxable year | $162,089.19 | |
| Less war profits credit | 78,647.05 | |

| | | |
|---|---|---|
| Taxable at 80% | $ 83,442.14 | $ 66,753.71 |
| Less excess profits tax | | 35,229.75 |
| War profits tax | | $ 31,523.96 |
| Total excess profits and war profits tax | | 66,753.71 |
| Tax applicable to Government Contracts (13.55%) | | 9,045.13 |

[fol. 17] Schedule 10

Computation of Total Tax (1919)

| Excess Profits Tax | Income | Tax |
|---|---|---|
| Net income for taxable year | $162,089.19 | |
| Less excess profits credit | 61,917.64 | |
| Balance | $100,171.55 | |
| Taxable at 20% | 85,376.46 | $ 17,075.29 |
| Taxable at 40% | 14,795.09 | 5,918.04 |
| | $100,171.55 | $ 22,993.33 |
| Applicable to income other than Gov. Contracts (86.45%) | | $ 19,877.73 |
| Tax at 1918 rates applicable to Gov. Contracts | | 9,045.13 |
| Total excess and war profits tax | | $ 28,922.86 |

Income Tax:

| | | |
|---|---|---|
| Net income for taxable year | $162,089.19 | |
| Less: | | |
| Interest on obligations of United States not exempt | $ 8,567.21 | |
| Excess profits tax | 28,922.86 | |
| Exemption | 2,000.00 | |
| | 39,490.07 | |
| Taxable at 10% | 122,599.12 | $ 12,259.91 |
| Total, excess profits, and income taxes | | $ 41,182.77 |

| | | |
|---|---|---|
| Previously assessed: | | |
| Original #403041 | $ 30,328.81 | |
| Amended Return June, 1921— #400016 | 4,558.94 | |
| Amended Return Jan., 1922— #400029 | 8,231.51 | |
| Total previously assessed | | 43,119.26 |
| Overassessed | | $ 1,936.49 |

[fol. 18] EXHIBIT B TO PETITION

Copy

(Execute Separate Form for each Tax Period)

Claim for

Abatement of Tax Assessed

Credit Against Outstanding Assessments

X Refund of Taxes Illegally Collected

Refund of Amounts Paid for Stamps Used in Error or Excess

STATE OF PENNSYLVANIA,
County of Allegheny, ss:

Fawcus Machine Company, 2818 Smallman Street, Pittsburgh, Pa.

This deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below with reference to said statement are true and complete.

| Period | Year |
|---|---|
| From Jan. 1, 1919, to Dec. 31, 1919 | 1919 |

1. Business in which engaged: Machinery manufacturer.
2. Character of assessment or tax: Income and profits tax.
3. Amount of assessment or stamps purchased: $——.
4. Reduction of Tax Liability requested (Income and Profits Tax): $1,597.85.

5. Amount to be abated: $——.

6. Amount to be refunded (or such greater amount as is legally refundable) (see attached sheets): $1,597.85.

7. Dates of payment: (See Collector's receipts or indorsements of canceled checks.)

(If statement covers income tax liability, items 8-11, inclusive, must be answered.)

[fol. 19] 8. District in which return (if any) was filed: 23rd Pa.

9. District in which unpaid assessment appears: ——.

10. Amount of overpayment claimed as credit: $——.

11. Unpaid assessment against which credit is asked: period from —— to ——: $——.

Deponent verily believes that this application should be allowed for the following reasons:

The taxpayer's invested capital for the taxable year 1919, as finally adjusted in the Department's letter of May 13, 1924, was reduced by the amount of $33,294.68. This deduction represents the amount of the income taxes computed on income for the year preceding the taxable year prorated from the dates due and payable within the taxable year.

The United States Board of Tax Appeals in its decision in the Appeal of the Guaranty Construction Company, Docket Nos. 1828 and 1848, decided October 30, 1925, ruled that there is no warrant under the several Revenue Acts for requiring invested capital to be reduced for a taxable year, by income and profits taxes due and payable during the taxable year on account of taxes for the preceding year; and in effect held that Article 845 of Regulations 45 and Article 845 of Regulations 62 are invalid.

(Signed) Thomas J. Haley, Treasurer. (Seal.)

Sworn to and subscribed before me this 9th day of December, 1925. R. W. Combs, Notary Public. My commission expires at next Session of Senate. (Seal.)

[fol. 20] 1919

| | | |
|---|---|---|
| Taxable Net Income (A-2 letter May 13, 1924) | | $162,089.19 |
| Invested Capital | | 736,470.52 |
| Add 1917 overpayment (for which claim filed) | | 339.58 |
| Prorated 1918 income tax | | 33,294.68 |
| | | $770,104.78 |
| Less: | | |
| Original deduction for inadmissibles | $253.43 | |
| Corrected | 265.54 | 12.11 |
| Adjusted invested capital | | $770,092.67 |

Computation of Excess profits and War profits Credits

| | |
|---|---|
| Net income taxable year | $162,089.19 |
| Net income prewar period | 12,818.18 |
| Invested capital taxable year | $770,092.67 |
| Invested capital prewar period | 203,501.13 |
| Increase in invested capital for taxable year as compared with that for prewar period | $566,591.54 |

Excess Profits Credit

| | |
|---|---|
| 8% of invested capital | $61,607.41 |
| Exemption | 3,000.00 |
| Total credit | 64,607.41 |

War Profits Credit

| | |
|---|---|
| Average net income prewar period | $12,818.18 |
| Plus 10% of increase in invested capital | 56,659.15 |
| | $69,477.33 |
| 10% of invested capital | $77,009.27 |
| Exemption | 3,000.00 |
| Total credit | $80,009.27 |

[fol. 21] Computation of Total Tax (1918) Rates for Government Contracts

Excess Profits Tax

| | Income | Tax |
|---|---|---|
| Net income for taxable year | $162,089.19 | |
| Less: Excess Profits Credit | 64,607.41 | |
| Balance | $97,481.78 | |
| Taxable at 30% | 89,411.12 | $26,823.34 |
| Taxable at 65% | 8,070.66 | 5,245.93 |
| Total excess profits tax | | $32,069.27 |
| Net income for taxable year | $162,089.19 | |
| Less: War Profits Credit | 80,009.27 | |
| Taxable at 80% | $82,079.92 | $65,663.94 |
| Less excess profits tax | | 32,069.27 |
| War profits tax | | $33,594.67 |
| Total excess profits and war profits tax | | 65,663.94 |
| Total applicable to Government Contracts (13.55%) | | $8,897.46 |

Computation of Total Tax (1919 Rates)

Excess Profits Tax

| | | |
|---|---|---|
| Net income for taxable year | $162,089.19 | |
| Less: Excess Profits Credit | 64,607.41 | |
| Balance | $97,481.78 | |
| Taxable at 20% | 89,411.12 | $17,882.22 |
| Taxable at 40% | 8,070.66 | 3,228.26 |
| Total excess profits tax | | $21,110.48 |
| Total applicable to income other than Government contracts (86.45%) | | 18,250.61 |
| Tax at 1918 rates | | 8,897.46 |
| Total excess profits and war profits tax | | $27,147.47 |

[fol. 22] Income Tax

| | | | |
|---|---|---|---|
| Net income for taxable year | | $162,089.19 | |
| Less: | | | |
| Interest on U. S. obligations | $8,567.21 | | |
| Excess profits tax | 27,147.47 | | |
| Exemption | 2,000.00 | | |
| | | 37,714.68 | |
| Taxable at 10% | | $124,374.51 | $12,437.45 |
| Total income and profits taxes | | | $39,584.92 |
| Previously assessed: | | | |
| Acct. No. 403041 | | $30,328.81 | |
| June 1921 list, Acct. No. 400016 | | 4,558.94 | |
| Jan. 1922 list, Acct. No. 400029 | | 8,231.51 | |
| | | $43,119.26 | |
| Less: Overassessment refund (May 13, 1924) | | 1,936.49 | |
| | | | 41,182.77 |
| Overpayment | | | $1,597.85 |

[fol. 23] Exhibit C to Petition

Copy

Treasury Department, Washington

IT:R:CC:3:HRB. Dec. 21, 1925.

Fawcus Machine Company, 1606 First National Bank Bldg., Pittsburgh, Pa.

Sirs: Your claim for refund of $1,597.85, income tax for the year 1919, has been examined.

The claim is based upon the decision of the United States Board of Tax Appeals in the case of the Guaranty Construction Company to the effect that surplus at the beginning of any taxable year may not be reduced in computing invested capital on account of taxes payable within the year upon the income of the preceding taxable year.

You are advised that the Commissioner has not acquiesced in this determination by the United States Board of Tax Appeals.

The claim will, therefore, be rejected and listed on the next schedule to be approved by the Commissioner.

Respectfully, C. R. Nash, Assistant to the Commissioner, by W. T. Sherwood, Head of Division.

---

[fol. 24] II. General Traverse—Filed July 25, 1927

And now comes the Attorney General, on behalf of the United States, and answering the petition of the plaintiff herein, denies each and every allegation therein contained; and asks judgment that the petition be dismissed.

Herman J. Galloway, Assistant Attorney General.

A. H. McC.

---

III. Submission of Case

On May 6, 1929, this case was submitted on merits without argument by Messrs. Holmes, Brewster & Ivins, for plaintiff, and by Mr. Lisle A. Smith, for defendant.

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[fol. 25] IV. **Special Findings of Fact, Conclusion of Law and Memorandum by the Court**—Filed November 4, 1929

This case having been heard by the Court of Claims upon a stipulation of facts signed on behalf of the plaintiff by Holmes, Brewster & Ivins and on behalf of defendant by Assistant Attorney General Herman J. Galloway, the court makes the following

Special Findings of Fact

I

The plaintiff is and at all times hereinafter mentioned was a corporation duly organized and existing under the

laws of the State of Pennsylvania, now having its office and principal place of business at 2818 Smallman Street, Pittsburgh, Pennsylvania.

II

On or about the 15th day of March, 1920, the plaintiff filed with the then duly appointed, qualified, and acting collector of internal revenue for the 23d district of Pennsylvania, on Form 1120, its income and profits tax return for the taxable year ended December 31, 1919, accompanied by its Government contract profits tax return for the same period on Form 1120-S, and subsequent thereto in June, 1921, and in January, 1922, the plaintiff filed in the same manner amended income and profits tax returns and in January, 1922, also filed amended Government contract profits tax returns for the taxable year ended December 31, 1919. The plaintiff paid tax thereon as follows: $30,328.81 in four equal installments on or about the 15th days of March, June, September, and December, 1920, respectively; $4,558.94 on or about September 16, 1921; $8,231.51 on or about January 16, 1922, a total tax payment for the taxable year 1919 of $43,119.26.

III

The Commissioner of Internal Revenue in a letter dated May 13, 1924, determined the liability of the plaintiff for income and profits taxes for the taxable year 1919 to be [fol. 26] $41,182.77. Thereafter, by his certificate No. 673829, the Commissioner of Internal Revenue, pursuant to such determination, certified an overassessment of $1,936.49, which amount was refunded to the plaintiff by the collector of internal revenue with interest amounting to $269.07.

A copy of the letter referred to above is annexed to the petition as Exhibit A and is made a part hereof by reference.

IV

Under the provisions of the revenue act of 1918, more particularly section 326 thereof, the invested capital of a corporation includes cash and property (subject to certain limitations) paid in for stock and paid-in or earned surplus

and undivided profits, not including surplus and undivided profits earned during the year. The total taxes due from plaintiff for the year 1918 amounted to $78,784.95, which were paid in four equal installments on or about the 15th days of March, June, September, and December, 1919. Under the regulations then in force in respect of such taxable year applicable to the relationship between invested capital of one year and taxes of the preceding year the amount of such taxes was included by the Commissioner of Internal Revenue in the invested capital of the plaintiff for the year 1919 until the installments were actually paid. This was accomplished by determining the average deduction for the year and reducing the earned surplus on January 1, 1919, by that amount. The amount of the average deduction was $33,294.68.

V

During the taxable year 1919 at the time each installment of 1918 income and profits taxes of the plaintiff became due and payable, the plaintiff had on hand surplus or undivided profits, earned during the taxable year 1919, more more than sufficient to pay such installment.

VI

The determination of the invested capital of the plaintiff for the taxable year 1919 made by the commissioner further involved the adjustment of surplus as at the beginning of the taxable year 1919 on account of 1917 taxes, as contained in item (e) of schedule 3, and explained in item (e) of schedule 4 of the commissioner's said letter dated May 13, 1924, which shows the correct tax liability for the year 1917 as $94,370.96.

VII

During all of the years involved in this action the books of the plaintiff were kept, and its income and profits tax returns were filed, on the accrual basis.

VIII

On or about December 11, 1925, the plaintiff filed, with the collector of internal revenue for the 23d district of

Pennsylvania for transmission to the Commissioner of In-
[fol. 27] ternal Revenue a claim for refund of excess tax in the amount of $1,597.85.

A copy of said claim is annexed to the petition as Exhibit B and made a part hereof by reference.

IX

On or about December 21, 1925, the Commissioner of Internal Revenue by a letter rejected said claim for refund.

A copy of said letter is annexed to the petition as Exhibit C and made a part hereof by reference.

X

On February 5, 1926, the plaintiff filed in this court a petition setting forth the foregoing facts and seeking judgment against the United States in the sum of $1,597.85, with interest and costs. In February, 1927, the attorney for the defendant moved that said case be dismissed for lack of prosecution. The attorneys for the plaintiff indorsed "No objection" on said motion and it was granted on February 14, 1927. Such dismissal was not upon the merits, which were never presented to the court.

XI

The plaintiff is and always has been the sole owner of the claim herein referred to and has not assigned or transferred the whole or any part thereof or interest therein. It has at all times borne true allegiance to the Government of the United States and has not in any way aided, abetted, or given encouragement to rebellion against the said Government.

Conclusion of Law

Upon the foregoing special findings of fact, which are made part of the judgment herein, the court decides as a conclusion of law that the plaintiff is not entitled to recover and the petition is therefore dismissed. Judgment is rendered against the plaintiff in favor of the United States for the cost of printing the record in this case, the amount thereof to be ascertained by the clerk and collected by him according to law.

MEMORANDUM

This case falls within the decision of the Supreme Court in the case of United States v. Yale & Towne Mfg. Co., 269 U. S. 422, and the following citations, viz: Nichols v. Sylvester Co., 16 Fed. (2d) 98; Bowers v. Kaufmann & Co., 18 Fed. (2d) 69; Russel Wheel and Foundry Company; 3 B. T. A. 1168. The petition is dismissed. It is so ordered.

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[fol. 28] V. JUDGMENT

At a Court of Claims held in the City of Washington on the 4th day of November, A. D., 1929, judgment was ordered to be entered as follows:

Upon the special findings of fact, which are made a part of the judgment herein, the court decides, as a conclusion of law, that the plaintiff is not entitled to recover, and the petition is therefore dismissed.

Judgment is rendered against the plaintiff in favor of the United States for the cost of printing the record in this case, the amount thereof to be ascertained by the clerk and collected by him according to law. No printing having been done by the court, no costs are taxed.

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[fol. 29] Clerk's certificate to foregoing transcript omitted in printing.

Endorsed on cover: File No. 34,756. Court of Claims. Term No. 625. Fawcus Machine Company, petitioner, vs. The United States. Petition for writ of certiorari and exhibit thereto. Filed February 4, 1930. File No. 34,756.

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed April 21, 1930

The petition herein for a writ of certiorari to the Court of Claims is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(3650)

FILE COPY

MAR 12

No. 40

IN THE

# Supreme Court of the United States

OCTOBER TERM 1929

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FAWCUS MACHINE COMPANY, a Corporation,
Petitioner,

v.

THE UNITED STATES OF AMERICA

---

## BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

---

J. S. Y. IVINS,
Attorney for Petitioner.
c/o HOLMES, BREWSTER & IVINS,
815 Fifteenth Street, N. W.,
Washington, D. C.

Rufus H. Darby Printing Co. Inc., Washington, D. C.

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No. 625

IN THE

# Supreme Court of the United States

OCTOBER TERM 1929

FAWCUS MACHINE COMPANY, a Corporation,
Petitioner,

v.

THE UNITED STATES OF AMERICA

## BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

### OPINION BELOW

The Court of Claims rendered no opinion except the following memorandum:

"This case falls within the decision of the Supreme Court in the case of *United States* v. *Yale & Towne Mfg. Co.*, 269 U. S. 422, and the following citations, viz: *Nichols* v. *Sylvester Co.*, 16 Fed. (2d) 98; *Bowers* v. *Kaufmann & Co.*, 18 Fed. (2d) 69; *Russel Wheel and Foundry Company*, 3 B. T. A. 1168. The petition is dismissed. It is so ordered." (R. 28).

It has not yet been officially reported in the Court of Claims Reports.

### JURISDICTION

The judgment of the Court of Claims was entered on November 4, 1929 (R. 28). The jurisdiction of this Court is invoked under Section 288 of the United States Code (Act of February 13, 1925, ch. 229, § 3).

## STATEMENT

This case was instituted by the petitioner in the Court of Claims to recover excess profits taxes for the year 1919 alleged to have been overpaid. The Court of Claims, after finding the facts in accordance with a stipulation by the parties, dismissed the petition with the memorandum quoted above.

The petitioner in March, 1920, filed its income and profits tax return for the calendar year 1919 (R. 25 ¶ II) and subsequently filed amended returns. The total amount originally paid (in various installments) was $43,119.26 (R. 25 ¶ II). The Commissioner of Internal Revenue determined the petitioner's liability for taxes for 1919 to be $41,182.77. The difference was refunded (R. 25 ¶ III). The petitioner claims that the further sum of $1,597.85 should have been refunded on the ground that the Commissioner erroneously reduced petitioner's invested capital for 1919 below the correct amount allowable under the statute.

Under the provisions of the Revenue Act of 1918, more particularly Section 326 thereof, the invested capital of a corporation includes cash and property (subject to certain limitations) paid in for stock, and paid-in or earned surplus and undivided profits, not including surplus and undivided profits earned during the year. The total taxes due from plaintiff for the year 1918 amounted to $78,784.95, which were paid in four equal installments on or about the 15th days of March, June, September, and December, 1919. Under the regulations then in force in respect of such taxable year applicable to the relationship between invested capital of one year and taxes of the preceding year the amount of such taxes was included by the Commissioner of Internal Revenue

in the invested capital of the plaintiff for the year 1919 only until the installments were actually paid, the balance being excluded. This was accomplished by determining the average deduction for the year and reducing the earned surplus on January 1, 1919, by that amount. The amount of the average deduction was $33,294.68.

During the taxable year 1919, at the time each installment of 1918 income and profits taxes of the plaintiff became due and payable, the plaintiff had on hand surplus or undivided profits, earned during the taxable year 1919. more than sufficient to pay such installment (R. 26 ¶ V).

Petitioner claims that its earned surplus for 1919 should not have been thus reduced and that the difference in taxes attributable to such erroneous reduction should be refunded.

## SPECIFICATION OF ERRORS TO BE URGED

The Court of Claims erred in holding that the plaintiff was not entitled to recover and that the petition should be dismissed. The decision of the Court of Claims amounted to a ruling that the Commissioner of Internal Revenue acted correctly in reducing the petitioner's 1919 invested capital by the amount of its 1918 income taxes prorated from dates of payment.

The decision of the court necessarily involves either (1) a ruling that petitioner was required by the Revenue Act of 1918 to accrue a tax as of a date prior to the passage of the statute imposing the tax although at that time it would obviously have been impossible to determine the amount to be accrued, or (2) a ruling to the effect that in the Revenue Act of 1926 Congress, without amending the Revenue Act of 1918, could take upon

itself the judicial function of interpreting the Revenue Act of 1918.

## SUMMARY OF THE ARGUMENT

### I. Invested Capital is Not Affected by Current Earnings or Expenses.

Article 845 of Regulations 45 was based upon two fallacies, to wit: (1) that income taxes are payable out of the net income of the taxable year for which they are levied; and (2) that it was possible to determine 1918 income taxes at the end of 1918 (the Revenue Act of 1918 not being passed until February, 1919).

### II. Income and Profits Taxes are Current Expenses When Due and Payable.

They are properly payable out of current earnings for the year in which they become due and payable.

### III. The Opinion of This Court in United States v. Anderson (260 U. S. 422) is not Applicable to Invested Capital for the Year 1919.

The court was there concerned with income, not with invested capital. It based its decision on the fact that all the events necessary to fix the tax had occurred before the end of the taxable year. In this case, the primary event—the passage of the statute imposing the tax —did not occur until after the close of the taxable year.

### IV. A Tax Cannot Be Determined Before the Passage of the Statute Enacting it.

Consequently, a tax cannot be accrued on the books of the taxpayer until the enactment of the statute imposing the tax, as has been held in various cases at the instance of the Government.

**V. The Congressional Intent in the 1918 Act.**

Congressional Committee Reports show clearly that Congress expected the 1918 taxes to be paid out of 1919 income.

**VI. Section 1207 of the Revenue Act of 1926 is Not Applicable to the Facts of This Case.**

The purpose of Section 1207 was to relieve the Treasury Department from the burden of attempting to collect additional excess profits taxes based on a hasty construction of *United States* v. *Anderson*, 269 U. S. 422, and was not intended to determine the question whether taxes as already collected were in part erroneous.

**VII. The Treasury Department's Construction of Section 1207 of the 1926 Act Raises Serious Doubts as to its Constitutionality. Such a Construction is Avoidable.**

To declare what the law has been is a judicial function. The Revenue Act of 1926 did not purport to amend the Revenue Act of 1918. To treat it as a construction would render it a usurpation of the power of the courts.

Section 1207 of the Revenue Act of 1926 on its face shows an intent to relieve the Treasury from the duty of going after additional taxes without interfering with the right of the courts to hold that some of the taxes as previously collected were erroneous.

**VIII. The Authorities Cited Below Distinguished.**

The court cases cited do not involve facts similar to those in the instant case, nor therefore the same issue. The Board decision mentioned includes no reasoning and is therefore of little weight.

## ARGUMENT

### I. Invested Capital is Not Affected by Current Earnings or Expenses.

The Treasury Department promulgated Article 845 of Regulations 45* on the theory that income and profits taxes for a given year, although not due and payable until certain dates in the following year, were determinable at the close of the given year, and should be deemed to have been paid out of the income of that

*Article 845 reads:

"*Surplus and Undivided Profits; Reserve for Income and Excess Profits Taxes.*—For the purpose of computing invested capital federal income and war profits and excess profits taxes are deemed to have been paid out of the net income of the taxable year for which they are levied. It is immaterial, therefore, whether reserves for the payment of such taxes for the preceding year have been set up or not, or if set up whether such taxes when paid have actually been charged against such reserves. Amounts payable on account of such taxes for the preceding year may be included in the computation of invested capital only until such taxes become due and payable. A deduction from the invested capital as of the beginning of the taxable year must therefore be made for such taxes or any installment thereof, averaged for the proportionate part of the taxable year after the date when the tax or the installment is due and payable. Where as a result of an audit by the Commissioner, or the acceptance of an amended return, or for any other reason, the amount of any such tax for the preceding year is subsequently changed, a corresponding adjustment will be made in the invested capital for the taxable year upon the same basis as if the corrected amount of the tax for the preceding year had been used in the original computation of the invested capital for the taxable year. See articles 1541 and 1542."

year. However, because they were not due and payable within the year, but so much of the income of the taxable year remained among the assets of the taxpayer until dates for payment in the next year, the regulation permitted "amounts payable on account of such taxes" to be included in invested capital in the next year, but "only until such taxes become due and payable."

This regulation was based upon two fallacies: (1) there is no basis for regarding income taxes as payable out of the net income of the taxable year for which they are levied; and (2) in the case of taxes for the calendar year 1918, at least, they were not determinable at the end of that year.

A corporation commenced a taxable year with invested capital consisting of (a) cash and property (subject to limitations contained in Section 326 of the Revenue Act of 1918) paid in for stock, and (b) paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year. This invested capital might be increased during the year by the payment in of additional capital in exchange for new stock, or by way of paid-in surplus, but not by current profits —they would only affect surplus as at the end of the year and go into the invested capital of the following year. By the same token, the invested capital would be reduced only by *capital paid out* during the year (e. g. liquidating dividends or dividends paid out of previously earned surplus, but not dividends paid out of cur-

rent earnings). Current expenses of any kind, would not reduce the invested capital for the year, for until the end of the year it would be impossible to tell whether such expenses exceeded receipts, and they would presumably be paid out of the current receipts for the year. If they did prove to exceed receipts, the difference would be a loss for the year—the converse of current profits—which would reduce surplus only as at the end of the year, and like surplus earned during the year, be reflected in the *next* year's invested capital.

So the average invested capital for a year would be the initial invested capital plus additional capital paid in by stockholders (not earnings) for the fraction of the year subsequent to its payment-in, and minus *capital* (including surplus carried over from the previous year) paid out to stockholders, for the fraction of the year subsequent to its payment-out. Payments to stockholders out of current earning did not reduce average invested capital, any more than the receipt and retention of current earnings increased it. And payments to others than stockholders did not reduce average invested capital for the year any more than receipts from others than stockholders, for only at the end of the year could it be determined whether the disbursements exceeded the receipts—whether there was profit or loss—whether earned surplus should be increased or reduced. *And the statute certainly did not contemplate the reduction of average invested capital for the year by current losses, when it specifically prohibited its increase by current earnings.*

Distributions to stockholders by way of dividends( except liquidating dividends), are presumed paid out of current earnings.*

If payments to stockholders out of current earnings do not reduce average invested capital for the current year, a fortiori payments to others out of current earnings do not reduce average invested capital. Business expenses are presumed paid out of earnings, not capital. And taxes, including income taxes, are business expenses. They were even deductible in computing taxable net income under the Corporation Excise Tax Act of 1909 and the Revenue Acts of 1913 and 1916. In the subsequent Revenue Acts** the deduction of Federal income and profits taxes was specifically prohibited in the computation of *taxable* net income, but the statutes made no provision that their payment should affect *invested capital.*

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* Rev. Act of 1918 § 201 (b). "Any distribution shall be deemed to have been made from earnings or profits unless all earnings and profits have first been distributed * * *." § 201 (e). "Any distribution made during the first sixty days of any taxable year shall be deemed to have been made from earnings or profits accumulated during the preceding taxable years; but any distribution made during the remainder of the taxable year shall be deemed to have been made from earnings or profits accumulated between the close of the preceding taxable year and the date of distribution, to the extent of such earnings or profits * * *." The first passage quoted is a recognition of a well settled legal principle, the second obviously an arbitrary rule of convenience. In accordance with this principle the average invested capital of a corporation is not reduced by the Treasury Department, on account of dividends paid, after the first sixty days of the year, out of current earnings. cf. *Appeal of L. S. Ayers & Co.*, 1 B. T. A. 1135.

** cf. Rev. Act 1918, § 214 (a) (3).

## II. Income and Profits Taxes are Current Expenses When Due and Payable.

The validity of Article 845 of Regulations 45 was first questioned in *Appeal of Guarantee Construction Co.*, 2 B. T. A., 1145, where the Board of Tax Appeals said (p. 1150):

> "Income and profits taxes are a current annual expense as much as taxes imposed by any State or any political subdivision thereof, not including taxes assessed against local benefits. The fact that they are specifically excluded from the deductions allowed by the statute in determining the taxable net income does not in the least change their character. As annual expenses they constitute for accounting purposes proper charges against the earnings of the year in which they become due and payable, and the payment thereof can have no more effect upon the invested capital of the year in which the payment is made than would the payment of any other operating expense.
>
> "Nor is the rule different in the event that the current earnings available at the date of payment of the tax or any installment thereof are insufficient to meet the required payment. By express provision of the statute the earnings of the current year are in no wise reflected in the current year's invested capital. It follows that if the expenses at any given date exceed the income so as to show an operating deficit at that date, invested capital is not affected.
>
> "Section 326 (d) provides that: 'The invested capital for any period shall be the average invested capital for such period, * * *' and it might be urged that, in the event the tax for an earlier year paid in a later year exceeded the earnings of that year,

the resulting impairment of surplus should be reflected in invested capital for the year in which such tax became due and payable. We believe, however, that full effect may be given to the above-quoted section without requiring such a construction. Additions to capital resulting from the issuance of additional stock for a valuable consideration or reductions of capital or surplus resulting from distributions to stockholders in excess of earnings, thereby producing impairments of surplus, are necessarily to be taken into consideration as bearing upon invested capital since they affect the capital actually embarked or left in the enterprise. Since this provision of the statute may thus be given full effect without involving adjustments of income or expense of the year, we are of the opinion that there is nothing in the statute which requires that the invested capital of a taxable year be reduced on account of the payment of income and profits taxes for the preceding taxable year.

"We conclude that, so far as article 845 of Regulations 45 and 62, promulgated by the Commissioner, requires that such reduction in the invested capital be made, such regulations are without statutory warrant and are invalid. Any part of the deficiency on appeal which is predicated upon the reduction of this taxpayer's invested capital for 1919 on account of income and profits taxes for the year 1918, whether paid in the year 1919 or forming a part of the deficiency for the year 1918, is erroneous and is disallowed."

It is respectfully submitted that the reasoning of the Board was sound. In the case at bar the taxpayer's po-

sition is even stronger, for it appears (R. p. 26, ¶ V) that at the time of each payment on account of 1918 taxes in 1919, the taxpayer had on hand earnings of 1919 sufficient to meet it.

The Board's decision followed that in *Appeal of L. S. Ayers & Co.*, 1 B. T. A. 1135, where the Board held:

> "The invested capital of a corporation may not be reduced, in determining the extent to which a dividend is paid from current earnings of a year, by a 'tentative tax' theoretically set aside out of such earnings pro rata over such year, because the income and profits tax does not become due and payable, and, therefore, does not accrue, until the following year."

This decision, approved in *Com'r* v. *Pittsburgh Knife & Forge Co.*, 30 Fed. (2d) 522 (C. C. A. 3rd) and *Blair* v. *Ragley Lumber Co.*, 30 Fed. (2d) 683 (C. C. A. 5th), after some hesitation, has been accepted by the Treasury Department as the law, and is being regularly applied for all years in which the excess profits taxes were in force, notwithstanding certain decisions of the Court of Claims in apparent conflict.

### III. The Opinion of This Court in United States v. Anderson is Not Applicable to Invested Capital for the Year 1919.

After the Board of Tax Appeals decided the *Guarantee Construction Company* case, this Court rendered its opinion in *United States* v. *Anderson* and *United States* v. *Yale & Towne Mfg. Co.*, 269 U. S. 422.* In that case this Court considered the question of whether a corpora-

* Cited under latter title in Memorandum below, R. p. 28.

tion which set aside on its books a reserve for Munitions Taxes for 1916, currently in 1916, should deduct those taxes from 1916 income, or from the income of 1917, in which year they were actually paid. It held that they should be deducted from 1916 *income*. The Court was not concerned with *invested capital*. It quoted Section 13 (d) of the Revenue Act of 1916, covering the computation of income, a provision *which has no counterpart in the sections of the 1918 Act covering invested capital.*

This Court said:

> "Only a word need be said with reference to the contention that the tax upon munitions manufactured and sold in 1916 did not accrue until 1917. In a technical legal sense it may be argued that a tax does not accrue until it has been assessed and becomes due; *but it is also true that in advance of the assessment of a tax all the events may occur which fix the amount of the tax and determine the liability of the taxpayer to pay it.*" (Italics supplied).

The Court, on the ground that *all such events had occurred* in 1916, held the tax deductible from 1916 income by a corporation which had set aside a reserve in 1916 to meet the tax. The Court said nothing with respect to the treatment of a tax which could not have been determined in 1916, but the inference is fair that the tax would not have been deductible for a year by the end of which all the events necessary to a determination of the liability *had not occurred*. The Court distinguished *United States* v. *Woodward*, 256 U. S. 632, on the ground that there

"It did not appear * * * as here, events had occurred before the tax became due which fixed the amount of it."*

The Court did not overrule the *Woodward* case, nor the cases of *Clapp* v. *Mason*, 94 U. S. 589, 592; *Mason* v. *Sargent*, 104 U. S. 689, 693; *Sturges* v. *United States*, 117 U. S. 363; *Wilmington Trust Co.* v. *United States*, 28 Fed. (2d) 205, 207, either directly or by implication.

In the case at bar all the events necessary for the determination of the petitioner's 1918 tax had not occurred by December 31, 1918. The first element in the determination of a tax is the statute under which it is assessable. *And the so-called Revenue Act of 1918 was not enacted until February 24, 1919.*

## IV. A Tax Cannot be Determined Before the Passage of the Statute Enacting it.

The case of *Schuster & Co., Inc.*, v. *Williams*, 283 Fed. 115, is exactly in point. In that case the taxpayer, a corporation making its returns on the accrual basis, sought to deduct from its gross income in computing its 1918 Federal income tax, a surtax on its income for that year imposed by the State of Wisconsin under a Soldiers' Bonus Act passed in 1919.

The Circuit Court of Appeals, affirming the decision of the District Court, and *sustaining the Government's contention*, said (p. 116):

"Since the act creating the tax was not passed until after the federal income tax year of 1918, this

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* cf. Government's brief in *United States* v. *Anderson*, pp. 38-40, distinguishing the *Woodward* case on the ground that *"various events subsequent to the date of the decedent's death * * * were necessary factors in computing the amount of the tax."* And *"an attempted accrual would have been a mere speculation."*

soldiers' bonus tax can *in no sense* be deemed to have accrued during the calendar year prior to that of its passage." Citing *United States* v. *Woodward* et al., 256 U. S. 632. (Italics supplied).

If the Wisconsin bonus tax was not deductible in 1918 because, being imposed by a law enacted in 1919, it did not *accrue* as a liability in 1918, it follows that the Federal income and profits taxes for 1918, imposed by a law enacted in 1919, could not have accrued as a liability during or at the end of the year 1918.

After the decision of *United States* v. *Anderson*, the General Counsel of the Bureau of Internal Revenue ruled that the *Anderson* case did not apply to the time of accrual of property taxes, which could not accrue until the tax roll had been completed, the value assessed and the rate determined (G. C. M. 1240, C. B. VI-1 p. 65). In Appeal of *Petaluma & Santa Rosa R. R. Co.* v. *Commissioner*, 11 B. T. A. 541, the Board of Tax Appeals held that the *Anderson* case did not apply to the time of accrual of the California franchise tax where the tax was measured by the receipts of the preceding year, since there was no liability for the tax for that year and never would have been had the corporation ceased to operate at the end of the preceding year.

In *Appeal of L. S. Ayers & Co.*,* referred to above, the Board of Tax Appeals aptly said:

"If the tax imposed by Congress under the Revenue Act of 1917 did not constitute such an impairment of surplus as to invalidate a declaration of dividend made prior to the passage of the Act, how

* The Court is respectfully referred to this opinion (1 B. T. A. 1135) for an exhaustive review of the authorities on accrual of taxes.

> can it be said that earnings during the year 1918 were *pro tanto* set aside or subject to be set aside for the payment of a tax not then existing and not brought into existence until February, 1919?

and:

> "It is not to be assumed that Congress intended the computation of invested capital to be unnecessarily complex by a strained interpretation which reduces the earnings of the year otherwise available for distribution on account of a tax thereafter to be imposed."

Similar rulings by the Treasury Department are found in O. D. 1118, 5 C. B. p. 133; I. T. 1498, C. B. I-2 p. 95; I. T. 2118, C. B. III-2 pp. 251, 253; I. T. 2281, C. B. V-1 p. 58; I. T. 2304, C. B. V-1 p. 74.

It is respectfully submitted that *United States* v. *Anderson* is not authority for the proposition that a tax can accrue as a liability before the passage of the statute enacting it.

**V. The Congressional Intent in the 1918 Act.**

Some light as to the legislative purpose of Congress is given by the report of the Senate Finance Committee on the 1918 Revenue Act. Prior to the enactment of the Revenue Act of 1917 Federal income taxes were deductible in the ascertainment of net income. A change was made by that act whereby all taxes were allowed as deductions *except* income and excess profits taxes imposed by authority of the United States, and, of course, taxes assessed against local benefits. The Senate Finance Committee, in its report approving the bill, stated:

> "Second. That in arriving at the net income no deduction shall be allowed for income and war-prof-

its taxes paid during the year. The amount of these taxes payable during the fiscal year 1918, principally between June 15 and 25, it is estimated will be about $1,400,000,000. If in computing the net taxable income of the year 1918 this amount be deducted the revenues of the Government would be reduced for the fiscal year 1919 to such an extent as to require a considerable increase in the rate of the income tax and possibly in the war-profits tax."

The Committee was speaking of the taxes imposed by the 1917 law, becoming due and payable during 1918, and contemplated (except for the amendment) the deduction of such taxes from 1918 receipts in the ascertainment of the net income on which the 1918 taxes collectible in 1919 would be based. Clearly, we submit, Congress had no thought of the deduction of the 1917 taxes from the 1917 gross income in the ascertainment of the 1917 tax. It follows then that the earned surplus for 1917 could not be reduced by the 1917 taxes, since the taxes were deemed by Congress to be chargeable against the 1918 income, except for the denial of the deduction. Similarly Congress never expected 1918 earned surplus to be reduced by 1918 taxes, which it expected would be paid out of 1919 income.

### VI. Section 1207 of the Revenue Act of 1926 is Not Applicable to the Facts of This Case.

Had this case been decided in 1925, there would, of course, have been no occasion to construe any statute other than the Revenue Act of 1918. But the Government contends that recovery in this suit is foreclosed by Section 1207 of the Revenue Act of 1926. The petitioner's position with respect to such a contention is that Section 1207 was not intended to have the effect given

it by the Treasury Department, but, if so construed, it would be of highly doubtful constitutionality, as an invasion by the legislature of the province of the judiciary.

The *Guarantee Construction Company* case was decided on October 30, 1925. The *Anderson* case was decided by this Court on January 4, 1926. The latter decision involved an entirely different question with respect to a tax of a fundamentally different nature imposed by a different revenue act.

A hasty construction of the *Anderson* case by the Treasury Department led to the conclusion that article 845 of Regulations 45 was wrong, not in the respect decided by the Board in the *Guarantee Construction Company* case, but because it permitted income and profits taxes of one year to remain in invested capital for any portion of the succeeding year. This conclusion meant that the Treasury Department, unless relieved by Congress, would feel obliged to reopen all closed cases against which the statute of limitations had not already run and assess additional taxes based on invested capital reduced by the entire rather than the partial deduction of prior years taxes. Not only that, but it meant also that the Department would not be able to close, without extended litigation, thousands of cases which could otherwise be settled. The Department was, therefore, faced with a very serious administrative problem.

In order to solve this administrative difficulty, the then pending revenue bill was amended by adding a paragraph which became Section 1207 of the 1926 Act. This section was intended solely to give the Treasury Department the necessary legislative authority to forego undertaking this huge administrative task which would otherwise have been necessary under the Department's interpretation of the effect of the *Anderson* decision. Clearly

there was no intention by Section 1207 retroactively to amend prior revenue acts to increase taxes for past years, nor, without retroactive amendment, to attempt legislatively to place an interpretation on the prior acts which would be binding on the courts. The purpose of the section was to relieve the Treasury Department from the difficulties and taxpayers from the burdens which would occur under the Treasury's theory of the *Anderson* case.

The Board of Tax Appeals, in *All America Cables, Inc.*, 10 B. T. A. 213, 218 ff. made a careful abstract of the regulations and decisions leading up to the enactment of Section 1207 of the Revenue Act of 1926, and said, in passing:

> "At this time [1926] many returns for the years affected by these regulations had been audited and the statute of limitations had run against the collection of the taxes on many of these returns in which the taxpayer had received the benefit of these regulations. The Treasury Department, therefore, was faced with the proposition of reversing its existing practice with respect to returns which were not yet closed, which would have meant an inequitable situation for these taxpayers as compared with more fortunate taxpayers who had the benefit of existing regulations. Congress apparently recognized this condition in enacting section 1207, which removed the question from the field of controversy and validated existing regulations with respect thereto."

The question removed from doubt was whether it was incumbent upon the Treasury to demand *still more* taxes from all corporations for the years 1917-1921 inclusive. The question in this case, i. e. whether the Commissioner had already asserted too much tax for *1918*, was not involved.

## VII. The Treasury Department's Construction of Section 1207 of the 1926 Act Raises Serious Doubts as to its Constitutionality. Such a Construction is Avoidable.

It is well settled that where a statute is susceptible of two constructions, by one of which grave constitutional doubts arise, and by the other of which such doubts are avoided, it is the duty of a court to adopt the latter.

*United States* v. *Delaware & Hudson Co.*, 213 U. S. 366, 407-408. *Texas* v. *Eastern Texas R. Co.*, 258 U. S. 204, 208.

As recently as January 2, 1929, this Court, in *Russell* v. *United States*, 278 U. S. 181, speaking with reference to the Revenue Act of 1924 said:

> "The changes introduced into the Act of 1926 cannot authorize construction of the earlier one not consonant with the language there employed."

As the legislature cannot set aside the construction of a law already applied by the courts, neither can it compel the courts for the future to adopt a particular construction of a law which the legislature permits to remain in force, unchanged. To declare what the law is, or has been, is a judicial power; to declare what the law shall be, is legislative. One of the fundamental principles of our government is, that the legislative power shall be separate from the judicial. If the legislature would prescribe a different rule for the future from that which the courts have enforced, it must be done by direct enactment, and cannot be done by a mandate to the courts, which leaves the law unchanged, but seeks to construe and apply it, not according to the judicial, but according to the legislative judgment. Cooley's Constitutional Limitations, 6th Ed., Chap. V, p. 113.

In *United States* v. *Salberg*, 287 Fed. 208, the court said:

> "A Legislature may enact a law, and, if not forbidden by the Constitution, may make it apply ex-post facto or retroactively; but the Legislature may declare what the law shall be, but not what it was."

The leading case on this point is probably *Town of Koshkonong* v. *Burton*, 104 U. S. 668 (1882). The plaintiff brought action against the defendant municipal corporation on a bond issued by the latter. The state statute in force at the time of the execution of the bond provided for a maximum rate of interest, and this act was construed by the state Supreme Court to permit compounding of interest. Subsequently the legislature passed an act declaring that "it was and is the true intent and meaning of" the prior statute that interest should *not* be compounded. This Court held this declaratory act was without effect so far as it concerned rights already accrued under the prior act, saying:

> "By the 1st section of the Act of 1868 the Legislature assumed to declare what was the true intent and meaning of previous legislation prescribing and limiting the rate of interest. * * *
>
> "Prior to the passage of the Act of 1868 the highest judicial tribunal of the State had adjudged that when a sum was to be paid at a specified time, as interest, that sum bore interest from that time until paid. This was an adjudication as to what was the local law in that class of cases. And the utmost effect to be given to a subsequent legislative declaration, as to what was the proper meaning of the statutes which had thus been the subject of judicial construction would be to regard it as an alteration of

the existing law in its application to future transactions, especially where, as was the case in the Act of 1868, that declaration was accompanied by a distinct provision, in terms, changing the pre-existing law.
* * *

"It is clear, therefore, that neither the Act of 1868, nor the provision quoted from the revision of 1878, which is but a continuation of the 2nd section of the Act of 1868, can be deemed applicable to the case before us. The contract between the Town and the holders of its securities was entered into prior to those enactments, and the rights of the parties must, necessarily, be determined by the law as it was when the contract was made. It was not within the constitutional power of the Legislature to take from the plaintiff his right, whether arising on express or implied contract, to interest upon interest, if when the coupons were executed and delivered, he, or the then holder thereof, had such right, under the law of the State."

It is clear that the 69th Congress could not constitutionally give to the words, "Paid-in or earned surplus, and undivided profits," in Section 326 of the 1918 Act, a meaning contrary to or different from that intended by the Congress that enacted that Act. Hence this Court will, if possible, give to Section 1207 an interpretation which does not imperil its constitutionality.

Congress undoubtedly recognized the constitutional limitation against performance of judicial functions by the legislative branch. That is evident from the language used in Section 1207.

Section 1207 is susceptible of a construction which will not imperil its constitutionality and which will not pre-

clude this Court from deciding this case upon the basis of the language of the Revenue Act of 1918.

Section 1207 reads as follows:

> "The computation of invested capital for any taxable year under the Revenue Act of 1917, the Revenue Act of 1918, and the Revenue Act of 1921, shall be considered as having been correctly made, *so far as relating to the inclusion in invested capital for such year of income, war-profits, or excess-profits taxes for the preceding year*, if made in accordance with the regulations in force in respect of such taxable year applicable to the relationship between invested capital of one year and taxes for the preceding year."

To analyze this section, it should be noted that the 69th Congress did not say, "The computation of invested capital * * * *was* correctly made * * * if made in accordance with the regulations * * *." Such language would clearly have evidenced the desire of Congress to deprive the courts of their judicial power to construe past legislative enactments. What it did say was, "The computation * * * *shall be considered as having been* correctly made * * *."

The choice of this phraseology shows that the sole purpose of the provision was to relieve the Treasury of reopening thousands of closed cases and holding open thousands of others while the question of the possible application of the rule of the munitions tax cases was being litigated in the courts.

It should be noted also that Congress put its stamp of approval on the Treasury regulations only so far as they related to the *inclusion* in invested capital of a particular year of income, war-profits, or excess-profits taxes

for the preceding year. The Commissioner had *included* only a part of such taxes. But Congress refrained from expressing its view on the propriety of the Commissioner's action in *excluding* a part of such taxes, leaving such question for determination in a proper case such as the instant one. This construction is supported by the presence in the section of the following clause:

> "so far as relating to the inclusion in invested capital for such year of income, war-profits, or excess-profits taxes for the preceding year,"—

for, if Congress intended retrospectively to adopt the regulations unqualifiedly and in their entirety, it would have referred to the general treatment of such taxes—not merely their *inclusion*, when it was well known that they had been partly included and partly excluded.

Accordingly, it is submitted that in deciding this case the Court may regard Section 1207 of the Revenue Act of 1926 as inapplicable.

**VIII. The Authorities Cited Below Distinguished.**

The Court of Claims dismissed the plaintiff's petition without opinion, merely citing three court cases, none of which dealt with a case involving the reduction of invested capital as at January 1, 1919, by taxes for 1918 computed under a statute enacted *after* January 1, 1919, and *none of which considered the impossibility of accruing a tax as of a date before the enactment of the statute imposing the tax*; and one Board decision in which no opinion was rendered on the issue herein involved.

The case of *United States* v. *Yale & Towne Mfg. Co.*, 269 U. S. 422, has been discussed under its more familiar title of *United States* v. *Anderson*.

In *Nichols* v. *Sylvester*, 16 Fed. (2d) 98, the statute involved was that of October 3, 1917, and the questions

were as to the *inclusion* of 1917 taxes in invested capital for 1918, whether Section 1207 of the Revenue Act of 1926 referred to regulations in force in 1918 or subsequent to the taxable year, and, accordingly, whether the Commissioner could collect taxes *in excess* of those contemplated by the regulations. The question at bar was not raised by either party or considered by the court. As this Court said in *United States* v. *Mitchell,* 271 U. S. 9, 14:

> "It is not to be thought that a question not raised by counsel or discussed in the opinion of the court has been decided merely because it existed in the record and might have been raised and considered."

In *Bowers* v. *Kaufmann,* 18 Fed. (2d) 69, the question arose with respect to reducing 1918 invested capital by taxes assessable under the 1917 Act—enacted *before* the date as at which the reduction was made.

In *Russel Wheel & Foundry Co.,* 3 B. T. A. 1168, the Board gave no reasoning but contented itself with quoting Section 1207 of the Revenue Act of 1926 and Article 845 of Regulations 45, and holding that the latter was in force when the former was enacted.

The failure of the Court of Claims to answer the contention of the petitioner suggests that it accepted the statement in the Government's brief, "Its [plaintiff's] income and profits taxes for 1918 had wholly accrued on December 31, 1918," citing the three court cases distinguished above. The Court of Claims made no effort to show how a tax could wholly accrue in the absence of a prime factor in its computation—the enactment of the statute under which it was both computed and assessed.

Its decision is in disregard of the opinion of this Court in *United States* v. *Woodward* and the cases cited above on p. 14.

It is respectfully submitted that the numerous taxpayers whose taxes for the calendar year 1918 are still in dispute are entitled to something better than this summary treatment, and to a hearing upon the question involved—that they may learn from this Court, in an opinion, the manner in which they might have been expected to accrue on December 31, 1918, an accurate estimated computation of taxes under a statute which was not yet on the books.*

## CONCLUSION

The Writ of Certiorari prayed for in the petition should be granted.

Respectfully submitted,

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*It is interesting to compare the position of the Government in this with that which it took in *Lucas* v. *American Code Co.* decided by this court in its favor on February 24, 1930.

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DEC 11 19

# In the Supreme Court of the United States.

OCTOBER TERM, 1930

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No. 40

FAWCUS MACHINE COMPANY, *Petitioner*

*vs.*

THE UNITED STATES

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ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

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## REPLY BRIEF FOR PETITIONER

---

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THE UNITED STATES

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ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

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## REPLY BRIEF FOR PETITIONER

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### I.

### THE REVENUE ACT OF 1918 WAS NOT AN AMENDMENT TO THE REVENUE ACT OF OCTOBER 3, 1917.

The Government's argument is predicated upon the statements that "The Revenue Act of 1918 was in effect an amendment to the Revenue Act of October 3, 1917." (Brief, p. 3) and that "The effect of the 1918 Act is in this respect to amend the Act of 1917; the basis of the tax is substantially identical in both statutes, the only difference being in the rates." (Brief, p. 12).

The Revenue Act of 1918 did not amend but com-

pletely replaced the Revenue Act of 1917. The language of Section 301 (a) of the Revenue Act of 1918 is:

> "That in lieu of the tax imposed by Title II of the Revenue Act of 1917,* * * there shall be levied * * * a tax equal to the sum of the following: * * *."

This expression is very different from the commonly accepted method of amending a statute, which, if applied here, would have read:

> Section 201 of Title II of the Revenue Act of 1917 is hereby amended to read as follows:

A comparison of the excess profits taxes imposed by Title II of the Revenue Act of 1917 and Title III of the Revenue Act of 1918 demonstrates that they differ not only in rates but in practically every other particular. Twenty-five of the most apparent differences are indicated in Appendix I hereto (p. 11).

Section 1400 of the Revenue Act of 1918 reads:

> "(a) That the following parts of Acts are hereby repealed, subject to the limitations provided in subdivision (b):
>
> "* * *
>
> "(3) The following titles of the Revenue Act of 1917:
>
> "Title I (called 'War Income Tax');
>
> "Title II (called 'War Excess-Profits Tax');
>
> "* * *
>
> "(b) Such parts of Acts shall remain in force for the assessment and collection of all taxes which have accrued thereunder, * * *: *Provided*, That, except as otherwise provided in this Act,

no taxes shall be collected under * * * Title I or II of the Revenue Act of 1917, in respect to any period after December 31, 1917: * * *."

The purpose of Congress is unmistakable. It completely repealed the excess profits tax titles of the Revenue Act of 1917, rendering them inapplicable to any part of the year 1918 and it substituted *"in lieu"* thereof war and excess profits taxes which differed in rates, in scope, in method of computing invested capital, in every important detail.

It should be noted that while the repeal carries a saving clause, the saving clause is specifically limited and under it no excess profits taxes can be deemed to have accrued under the Revenue Act of 1917 at December 31, 1918. It is of course true that on December 31, 1931 the Revenue Act of 1917 was still in force, but the retroactive repeal leaves us in a situation where for our purposes it can not be deemed to have been in force at any time after December 31, 1917.

## II.

## ARTICLE 845 OF REGULATIONS 45 WAS NOT A PROPER REGULATION UNDER THE REVENUE ACT OF 1918.

The basis of Article 845 is a presumption stated in the first sentence of that article—"For the purpose of computing invested capital, Federal income and war profits and excess profits taxes are deemed to have been paid out of the net income of the taxable year for which they are levied." We respectfully submit that the reasoning of the Board of Tax Appeals in *Appeal of Guarantee*

*Construction Company*,[1] quoted in our brief in support of the petition for certiorari at pages 10 and 11, is sound and that the presumption set up by the Commissioner is erroneous. The Senate Finance Committee, in the language quoted on pages 16 and 17 of our brief in support of the petition, indicated that Congress, fearing the effect of the deduction of 1917 taxes from 1918 taxable income, provided that no such deduction should be permitted. It did not have in mind substituting a deduction of 1918 taxes from 1918 income. If 1918 taxes do not go to reduce 1918 income, neither do they go to reduce earned surplus at the end of 1918 (see Point I of Brief in support of petition), since the taxes were deemed by Congress to be chargeable against the 1919 income except for the denial of the deduction. Earned surplus at the end of 1918 was a proper part of 1919 invested capital unless paid out to stockholders (after the exhaustion of current earnings) by way of dividends.

If 1918 profits were to be reduced by the 1918 taxes, the amount of such reduction would necessarily have to be set up as a reserve for Federal income taxes, such reserve being created by appropriations from surplus by an item that is *not deductible* from income for the purpose of computing the Federal income tax and would create a *true* reserve, being *a true appropriation of surplus*, and, as such, should be restored to surplus like any other true reserve for invested capital purposes the following year.

Assume that a taxpayer at the end of 1918, out of 1918 earnings set up a reserve for depreciation of $10,000.00 which is an *allowable deduction*, and set up a reserve of $10,000.00 for future contingent losses, and set up a

[1] 2 B. T. A. 1145, 1150.

reserve of $10,000.00 for Federal income taxes; the reserve for depreciation of $10,000.00 could not be restored to surplus because it is an *allowable deduction* for income tax purposes. The reserve of $10,000.00 for future contingent losses could be restored to surplus because it is an *unallowable* deduction, and it therefore follows that the reserve of $10,000.00 for Federal income taxes can also be restored to surplus because this item is also an *unallowable* deduction. Just where the line of distinction is drawn between two reserves of this kind we fail to understand. Let us say that a taxpayer on December 31, 1918 purchased $10,000.00 worth of raw materials and stored them in its warehouse and agreed to pay for it March 15, 1919, the following year. Under the theory laid down in Article 845, why does not the Commissioner also compel the taxpayer to prorate out the $10,000.00 during the year 1919 when it becomes due and payable? What is the difference between a liability for merchandise purchased, and a liability for accrued taxes? Why is the one item required to be prorated out of invested capital, and the other item that is just as much accrued, just as much determined to be payable, not required to be prorated out? It should be borne in mind that although Congress specifically prohibited the deduction of income and profits taxes in the computation of taxable net income, *it made no provision that the payment of these taxes should affect invested capital.*

The re-enactment of Section 326 (a) in the Revenue Act of 1921 does not furnish a rule for construing it in computing 1919 taxes. For the purpose of construing the Revenue Act of 1921, we may turn to the previous act from which it was copied and to the intervening de-

partmental construction and assume that the Sixty-seventh Congress in passing the 1921 Act intended to apply for 1921 and subsequent years the construction placed on the 1918 Act by Regulations 45 But this furnishes no clue to the intent of the Sixty-fifth Congress when it enacted the Revenue Act of 1918 in the light of no similar language in prior acts or interpreting regulations.

As shown under Point VII of our brief in support of the petition and in Appendix II to this brief, the function of a Congress is to legislate and not to interpret. It may amend the acts of prior Congresses, it may even for certain purposes amend them retroactively, but it can not, leaving them in effect, interpret them. That is the function of the courts alone. If a *direct* attempt by Congress to interpret a prior act is ineffective, *a fortiori* we can not say that the mere re-enactment of a statute by a subsequent Congress constitutes a controlling or even persuasive interpretation of the prior act.

As the Circuit Court of Appeals for the Second Circuit said in *Shearer* v. *Anderson*, 16 Fed. (2d) 995:

> "Whatever the effect of the departmental interpretation of the later act of 1918 may be on the construction of the same clause re-enacted by still later legislation, it cannot operate retroactively; we are here concerned with rights under the act of 1916. The later views of the department as to the meaning of this act can be at the best but persuasive."

## III

## THE METHOD OF COMPUTATION ADOPTED BY THE COMMISSIONER IN ARTICLE 845 OF REGULATIONS 45 IS UNREASONABLE AND UNJUST.

At the end of 1918 the petitioner had a surplus of $496,609.19[1] which it had accumulated in prior years. Of this amount, $65,220.80 was earmarked as reserved for taxes. But this reserve was part of the statutory invested capital of the petitioner. It represented moneys which had come in to the petitioner either by being paid in or coming in as taxable income and thus becoming capital. They would actually remain in the treasury of the corporation throughout 1919 unless distributed to stockholders as dividends or paid out as taxes. But before any of the reserve had been paid out by way of 1918 income taxes, there were current earnings for 1919 sufficient to meet them (Finding V—Record p. 26). Congress regarded the taxes of one year as normally going to reduce incomes of the next year and based its prohibition of such reductions upon that thought. The logic of reduction of invested capital for taxes paid and for dividends paid is the same, and the Treasury Department has accepted the rule in *Commissioner* v. *Pittsburg Knife & Forge Co.*[2] and *Blair* v. *Ragley Lumber Co.*,[3] which approved the decision of the Board of Tax Appeals in *Appeal of L. S. Ayers & Co.*,[4] in turn based on its decision in *Appeal of Guarantee Construction Co.*[5] (see Point II of brief in support of petition).

[1] Sum of second, third and fourth items on page 15 of record.
[2] 30 Fed. (2d) 683 (C.C.A. 5th).
[3] 30 Fed. (2d) 522 (C.C.A. 5th).
[4] 1 B.T.A. 1135.
[5] 2 B.T.A. 1145.

*Why should a corporation which had earnings in 1918, as yet undistributed, and which has further earnings in 1919 and makes a distribution of dividends and a payment of income taxes on March 15, 1919, be presumed to have paid the dividends out of 1919 income and the taxes out of 1918 income?* The Commissioner originally tried to presume that both were paid out of surplus existing at the beginning of the year. He was overruled with respect to both contentions by the Board of Tax Appeals. Then he misapplied the decision of this Court in *United States* v. *Anderson*,[1] which dealt solely with the adjustment of net income for munitions taxes and had nothing to do with adjustment of invested capital or the treatment of taxes of which Congress had prohibited the deduction.

This hasty construction of the *Anderson* case led to the enactment of Section 1207 of the Revenue Act of 1926, which, as we have shown,[2] only purported to ratify Regulations 45 in so far as the *inclusion* of income and profits taxes in invested capital was concerned. (This is admitted in Point III of the Government's brief, p. 16.) The Commissioner interpreted the new secton as ratifying the previous regulations with respect to both inclusions and exclusions, which was error. The Board of Tax Appeals in *Appeal of Russell Wheel & Foundry Company*,[3] without any reasoning, accepted the Commissioner's interpretation and has followed it blindly ever since. The decision in the *Russell Wheel & Foundry Company* case becomes no more logical through having been followed blindly by the same tribunal in twenty or a thousand cases. All of these decisions of the Board

[1] 269 U. S. 422—cited in the Government's brief as *United States* v. *Yale & Towne Mfg. Co.*

[2] Brief in support of petition, Points VI and VII.

[3] 3 B.T.A. 1168.

and the decision of the Circuit Court of Appeals in *W. S. Bogle & Co. Inc.* v. *Commissioner*,[1] are based on the same ground admitted on page 16 of the Government's brief to be fallacious.

## IV

## TO CONSTRUE SECTION 1207 OF THE REVENUE ACT OF 1926 AS AN INTERPRETATION OF THE 1918 ACT WOULD RENDER IT UNCONSTITUTIONAL.

Although the Government has admitted the inapplicability of Section 1207 of the Revenue Act of 1926 to the present case and has in effect admitted that the Board of Tax Apeals erred in the grounds it adopted for overruling its decision in *Appeal of Guarantee Construction Company*, it goes on to say that nevertheless a construction of Section 1207 as a ratification of Article 845 does not render it unconstitutional. In the light of this modification of the admission, and the Government's attempt to distinguish *Town of Koshkonong* v. *Burton*,[2] we have brought together a number of additional authorities on the question of the right of Congress to assume the judicial function of interpreting statutes. These authorities are indicated in Appendix II of this brief, p. 13.

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[1] 26 Fed. (2d) 771.
[2] 104 U. S. 668.

## CONCLUSION

The judgment of the Court of Claims should be reversed and the cause remanded for judgment in favor of the plaintiff.

Respectfully submitted,

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## APPENDIX I

*Some of the differences between the excess profits tax law contained in Title II of the Revenue Act of 1917 and the excess profits and war profits tax laws contained in Title III of the Revenue Act of 1918.*

The 1917 Act (§ 201) imposed the excess profits tax on corporations, partnerships and individuals; that of 1917 (§ 301) imposed it on corporations only.

The 1917 Act provided rates in five brackets (20%, 25%, 30%, 35%, 60%); that of 1918 provided three brackets (for 1918, 30%, 65%, 80%; for 1919, etc., 20%, 40%).

The 1918 Act provided a special tax (§ 301 (c)) on income from Government contracts, which had no counterpart in the 1917 Act.

The 1918 Act had a provision (§ 302) limiting the maximum tax, which had no counterpart in the 1917 Act.

Section 303 of the 1918 Act made special provision with respect to personal service corporations, which received no special treatment under the 1917 Act.

Section 304 (c) of the 1918 Act exempted net income derived from the mining of gold. This provision had no counterpart in the 1917 Act.

Section 201 (c) of the 1917 Act exempted incomes derived from the business of life, health and accident insurance combined in one policy issued on the weekly premium payment plan, which provision had no counterpart in the 1918 Act.

Section 305 of the 1918 Act provided for reducing the specific exemption for taxable periods of less than a year. There was nothing like this in the 1917 law.

The 1917 Act carried no "war profits tax" and consequently no "war profits credit." The provisions for computing the excess profits credit under the 1917 Act (§§ 203 (a), (b), (c), (d), 204, 205 (a), (b)) were totally different from the provisions for computing the excess profits credit under the 1918 Act (§ 312).

Section 320 (b) of the 1918 Act, providing for a method of computing average prewar income, had no counterpart in the 1917 Act.

The methods of computing invested capital under the two statutes (1918, §§ 325, 326; 1917, § 207) are different: the 1918 Act carrying definitions (§ 325 (a)) of intangible property, tangible property, borrowed capital, inadmissible assets and admissible assets, not paralleled in the 1917 law; the 1918 law providing a method (§ 325 (b)) not paralleled in the 1917 law for treatment of stock having no par value; the 1918 law (§ 326 (a)) considering property paid in at its value at the time paid in while the 1917 law (§ 207 (a)) took the value at January 1, 1914, of any property paid in before that date, the 1918 law (§ 326 (a)) also providing for the treatment of property paid in having a value in excess of the stock issued therefor as paid in surplus, which provision had no counterpart in the 1917 Act; the two statutes providing for quite different treatment of intangible property in invested capital (cf. 1918, § 326 (a) (4); 1917, § 207 (a)); the 1918 Act providing for adjusting invested capital by a ratio of "admissible" and "inadmissible" assets (§ 326 (c)), which had no counterpart in the 1917 law; the 1918 law (§ 326 (d)) carrying a provision for invested capital for fractional parts of years, not paralleled in the 1917 law.

The 1917 law (§ 209) provided a special method of taxing businesses having no invested capital or not more than a nominal capital. There was nothing like this in the 1918 law.

The provisions for "special assessment" contained in Section 210 of the 1917 law and Sections 327 and 328 of the 1918 law were quite different: The duty of trying to determine invested capital was imposed upon the Secretary of the Treasury by the 1917 Act (§ 210) and upon the Commissioner of Internal Revenue by that of 1918 (§ 327 (a)); the 1918 Act (§ 327 (b)) provided special assessment for all foreign corporations, not paralleled in the 1917 Act; the 1918 Act provided for special assessment (§ 327 (c)) in cases of mixed aggregate of tangible and intangible property and (§ 327 (d)) in cases of abnormal conditions working exceptional hardship, which provisions are not paralleled in the Act of 1917; section 328 (b) of the 1918 Act carried a provision for computation where the tax appeared to be more than 50% of the net income, not paralleled in the 1917 Act; and section 328 (c) of the 1918 Act had a provision for records and information to Congress, not paralleled in the Act of 1917.

## APPENDIX II

*Authorities supplementary to Point IV of foregoing brief and Point VII of brief in support of petition for certiorari.*

Section 1207 of the 1926 Revenue Act provides:

> "The computation of invested capital for any taxable year under the Revenue Act of 1917, the Revenue Act of 1918, and the Revenue Act of

1921, shall be considered as having been correctly made, so far as relating to the inclusion in invested capital for such year of income, war-profits, or excess-profits taxes for the preceding year, if made in accordance with the regulations in force in respect of such taxable year applicable to the relationship between invested capital of one year and taxes for the preceding year."

The case of *United States* v. *Heinszen & Co.*, 206 U. S. 370, cited on the Government's brief held constitutional an act of Congress ratifying the collection of duties in the Phillippine Islands under previous regulations established without authority by the President of the United States. As to the *Heinszen* case the following distinction has been made: In that case prior tax laws were not *construed*. The remedial act only made assessment and collection under prior tax laws enforceable without changing the construction of the tax laws themselves. Legislation which legalizes and renders collectible a tax previously invalid and uncollectible and merely supplies means by which payment may be enforced may be distinguished from legislation construing prior laws or reversing a construction already placed upon a tax law by the courts. (Compare cases like *United States* v. *Heinszen, & Co.*, *Rafferty* v. *Smith, Bell & Co.*, 257 U. S. 226, and *Charlotte Harbor Ry. Co.* v. *Welles*, 260 U. S. 8, cited on the Government's brief with the cases cited below and the *Salberg* and *Town of Koshkonong* cases cited in our brief in support of the petition.)

Apparently where the illegality of a tax arises solely from legislative failure to delegate the necessary authority to carry it into effect, a subsequent ratification is not

an usurpation of a judicial function and makes the statute effective *ab initio*. It merely confirms the law without determining its effect.

Section 1207 of the 1926 Revenue Act does not, like the statute involved in the *Heinszen* case, "legalize and ratify the collection" of the tax "the same as if the same had by prior act of Congress been specifically authorized and directed." We submit that the section amounts to no more than a legislative adoption of an administrative construction of prior legislative acts, leaving them in full force and effect without attempting to modify, alter or repeal them. There is no enacting language in the section.

The Treasury Department rulings may not alter, amend or extend a statute.

*Edwards* v. *Keith*, 231 Fed. 110;

*Munro Cider Vinegar & Fruit Co.* v. *Riordan*, 280 Fed. 624;

*Van Dyke* v. *City of Milwaukee*, 159 Wis. 460;

*Greenport Basin & Construction Co.* v. *U. S.*, 269 Fed. 58;

*De Laski* v. *Iredell*, 268 Fed. 377;

*Cryan* v. *Wardell*, 263 Fed. 248.

The following cases are cited as sustaining our contention that one Congress cannot *interpret* the Act of a prior Congress:

*Ogden* v. *Blackledge*, 2 Cranch 272, wherein the following appears in the report of the argument by counsel:

> "But the legislature of North Carolina passed a law in 1799 (c. 26), which declares, in substance,

that notwithstanding the 6th section of the act of 1789, the 9th section of the act of 1715 was not repealed. This, however, cannot affect the present case, for this action was brought in October 1798, before the law of 1799 was passed. But even if it had been brought after the law of 1799, that act could not alter the past law, and make that to have been a law which was not law at the time. To declare what law is, or has been, is a judicial power; to declare what the law shall be, is legislative. One of the fundamental principles of all our governments is, that the legislative power shall be separated from the judicial.

"The Court stopped the counsel, observing that it was unnecessary to argue that point."

The above statement from the report in the *Ogden* case is given judicial recognition in *Koshkonong* v. *Burton*, 104 U. S. 668, 678, and other cases cited below. The court in the *Ogden* case must have disregarded the explanatory act of 1799, or its judgment would have been different.

*Union Iron Co.* v. *Pierce*, Fed. Cas. No. 14,367, 24 Fed. Cas. 583, 4 Biss. 327, involving the construction of a statute providing officers neglecting to make required reports annually shall be individually liable for corporate debts contracted by them. The amendment provided that the word "annual" as used in the prior act "shall be construed to mean once a year after such company has been doing business at least twelve months." The court stated:

"It is urged that this legislative construction must govern us. There can be no doubt that the legislature intended, in passing this amendment, to assume the power to construe the 13th section

of the act proposed to be amended; and it is equally certain that the Indiana legislature can exercise on such power. The constitution of this state separates the powers of the state government into three departments—the legislative, the executive, and the judicial—and it prohibits each of these departments from exercising the powers conferred on either of the others. Now, to make a law is a legislative function, which no court can assume; and the construction of a law already made is a judicial act, which no legislature can constitutionally perform. The amendment in question is a judicial act in so far as it attempts to declare the meaning of the term 'annually' as it occurs in the 13th section of the old act. This amendment may operate as a future rule on subsequent transactions but it cannot operate retrospectively and on past events. It is a well-established rule of American jurisprudence, that all declaratory laws, as such, are unconstitutional."

*Postmaster-General* v. *Early*, 12 Wheat. 136 at 148, involving the jurisdiction of the federal courts, wherein the court stated:

"It has been said, and perhaps truly, that this section was not framed with the intention of vesting jurisdiction in the Circuit Courts. The title of the act, and the language of the sentence, are supposed to concur in sustaining this proposition. The title speaks only of State and District Courts. But it is well settled, that the title cannot restrain the enacting clause. It is true that the language of the section indicates the opinion, that jurisdiction existed in the Circuit Courts, rather than an intention to give it; and a mistaken opinion of the legislature concerning the law, does not make law.

But if this mistake be manifested in words competent to make the law in future, we know of no principle which can deny them this effect. The legislature may pass a declaratory act, which, though inoperative on the past, may act in future."

*Wheaton* v. *Peters,* Fed. Cas. No. 17,486, 29 Fed. Cas. 862, at 866, 33 U. S. (8 Pet) 725 wherein the court stated:

"a single sentence in the case of Postmaster *v.* Early, 12 Wheat. 148, has been relied on; the chief justice there says, 'it is true that the language of the section indicates an *opinion* that the jurisdiction *existed* in the circuit courts, rather than an *intention* to give it; and a mistaken opinion of the legislature concerning the law does not make law.' There is nothing but what is perfectly reasonable and familiar in this principle, and we can hardly suppose it was unknown to or disregarded by Judge Washington in the case of Ewer *v.* Coxe."

*Kern* v. *Supreme Council American Legion of Honor,* (Mo.) 67 S. W. 252, at 255, wherein the court stated;

"The act of March 8, 1881, is the only act that ever exempted foreign fraternal societies from the general insurance laws. It created such exemption for the first time, and, notwithstanding the recital in the emergency clause thereof, it was not simply a declaratory act, but was a creative act. That act was passed by the 31st general assembly, and it was not competent for that body by a declaratory act to ascribe a meaning or intention to the acts of March 8, 1879, or May 19, 1879, which the 30th general assembly had not expressed in those acts. The 31st general assem-

bly had power to prescribe what the law should be thereafter, but it was the province of the courts, and not of that session of the assembly, to say what the law was before that time. In other words, all laws must be prescribed by law-making power, and it is not within the power of a later assembly to declare that a prior assembly meant something it did not say in the laws enacted by it. The third point made by the defendant therefore also fails."

*City of Oakland* v. *Oakland Waterfront Company*, (Cal.) 50 Pac. 277, holding nugatory an act attempting as against rights that had vested meantime to re-define the boundary of a city fixed by a prior act.

Cooley's Constitutional Limitations, Eighth Edition, Volume One, page 191, stating:

> "As the legislature cannot set aside the construction of the law already applied by the courts to actual cases, neither can it compel the courts for the future to adopt a particular construction of a law which the legislature permits to remain in force. 'To declare what the law *is or has been* is a judicial power; to declare what the law *shall be*, is legislative. One of the fundamental principles of all our governments is, that the legislative power shall be separate from the judicial.' "

*Lindsay* v. *United States Savings & Loan Co.*, (Ala.) 42 L.R.A. 783, at 786, 24 So. 171, holding nugatory as to "premiums heretofore taken" by building and loan associations an act providing premiums heretofore or hereafter taken shall not be treated as interest nor render such association amenable to the laws relating to usury, wherein the court stated:

> "The enactment is its own expositor. Without repeal or modification of the statutes relating to interest and usury,—the statutes to which the former decision declared these transactions were offensive,—the enactment intervenes, and declares that, as to past or future transactions, they must not be so regarded. In form and words the enactment is not directed as a mandate to the courts, but it is without force or meaning, unless the courts depart from the former construction of the statute, and yield obedience to it. It is, of consequence, that which is known as an 'expository act.' Of such statutes it is said by Judge Cooley: 'As the legislature cannot set aside the construction of the law already applied by the courts to actual cases, neither can it compel the courts for the future to adopt a particular construction of a law which the legislature permits to remain in force. 'To declare what the law is, or has been, is a judicial power; to declare what the law shall be, is legislative. One of the fundamental principles of all our governments is that the legislative power shall be separate from the judicial.' "

*Bassett's case*, 2 Court of Claims 448, in which it was held that an amendatory act of Congress, providing

> "That the act entitled 'An act to increase the pay of soldiers in the United States Army, and for other purposes,' approved June 20, 1864, shall not be so construed as to increase the emoluments of the commissioned officers of the army at the date of its passage.' "

could not be effective to decrease pay earned prior to its passage, the Court stating:

"This clause in form directs as to the construction of the act of 1864, and to construe acts is the province of the judiciary. In The United States *v.* Dickson, 15, P., 141, the Supreme Court of the United States decided that 'the judicial department must determine the construction of all laws involved in cases before them according to their own views.' " (Curtis's Digest, p. 104.)

*The People, ex. rel. The Mutual Life Insurance Company of New York* v. *The Board of Supervisors of the City and County of New York*, 16 N. Y. 424 involves a taxation statute and therefore is of special interest. The Court stated:

"On the 24th March, 1855, a law was enacted declaring that the mutual companies incorporated prior to the general act should be subject to taxation on the sum of one hundred thousand dollars, 'and no more'. It was added, 'and it is hereby declared that such was the intention, and it is the true construction of said act, of June 29th, 1853, in regard to any taxes imposed on said companies after said act took effect.' (Laws of 1855, ch. 83.) All the judgments of the Supreme Court now under review were rendered at the special term before the enactment of this statute.

"The act in question, considered as a persuasive argument for a particular construction of the statute of 1853, loses much of its weight from the consideration that the legislative bodies had been renewed in the interval between the two enactments, and that but a few of the members of the legislature of 1853 sat in that of 1855; but if this were otherwise, we should feel constrained to rely upon the language of the statute which we are

called upon to interpret, rather than any personal assurance as to the intention of its members. The acts of the legislature do not rest in any respect upon oral tradition. They are committed to writing, and it is by the written language that their sense is to be ascertained. As an authoritative mandate in favor of the construction claimed by the insurance company we cannot accord to it any force whatever. In the division of power among the great departments of the government, the duty of expounding written laws has been committed to the judiciary. The legislature has no judicial power, and cannot upon any pretence interpose its authority respecting questions of interpretation pending in the courts. (Dash *v.* Van Kleeck 7 John., 477: Ogden *v.* Blackledge, 2 Cranch, 272.) We do not suppose that the legislature had any such design in passing this act. They had ample power to introduce a new rule upon this subject, and that rule I conceive might be made in a limited sense retrospective. As no vested private rights of individuals were disturbed, and the authority of the legislature over the subject of taxation was plenary, the new rule might, if considered expedient, be made applicable to questions of assessment depending before the administrative boards. This was probably all that was intended in this instance. We do not assume that it was designed to dictate to the courts, for this was not within the competency of the legislature; and beside, the act would have full effect if restricted in the manner I have suggested."

*United States* v. *Chong Sam*, 47 Fed. 878, at 886, involving the construction of a Federal Chinese Exclusion Act wherein it is stated:

"To declare what the law is or has been is a judicial power; to declare what the law shall be is legislative. Ogden *v.* Blackledge, 2 Cranch, 272, 277; Koshkonong *v.* Burton, 104 U. S. 668, 678; In re Landsberg, 11 Int. Rev. Rec. 150; Cooley, Const. Lim. pp. 93, 95, and cases cited."

*State Ex. rel. Rodwell* v. *Harrison,* (N. C.) 43 Southeastern 540. In this case a State statute provided that the election for the town of Littleton should be held annually on the first Monday in May. A subsequent act repealed this provision declaring that in all towns an election should be held on Tuesday after the first Monday in May 1901 and biennially thereafter. Notwithstanding this repeal an election was held in Littleton on the first Monday in May, 1902. Thereafter in 1903 a statute was passed declaring that it had been the intention of the general assembly in 1901 to except Littleton from the general Act relative to municipal elections and that consequently the election was valid. The Court held that the Act of 1903 could not be regarded as binding on the Courts with respect to a controversy relative to the validity of the election which arose prior to its passage, citing the Ogden case.

*In re Landsberg,* Fed. Cas. No. 8041, 11 Int. Rev. Rec. 142, 150, in which it was held that an Act of Congress providing that the provisions of a previous Act "shall be so construed as not to affect any right of suit or prosecution which may have accrued under any prior acts of Congress repealed" providing for the recovery of penalties and forfeitures arising under the customs laws was obnoxious as to two fatal objections:

"(1) It is an exercise of a power purely judicial in its character. Upon a question very much like the present in the U. S. Supreme Court, Chief Justice Marshall clearly stated the rule as follows: 'To declare what the law is, or has been, is a judicial power; to declare what the law shall be is legislative.' Ogden *vs.* Blackledge, 2 Cranch (6 U. S.) 272, 277. The previous act itself, is permitted to stand unaltered and unamended. Congress assumes the power simply to expound and construe it; a power purely and undoubtedly judicial. What the law was before the explanatory act, it was permitted to be after, and is today. To declare its meaning and application belongs exclusively to the judicial tribunals, and not to the legislature. It cannot be said that the act is prospective merely, and simply declares what the law shall be in the future, because by its express terms it relates exclusively to penalties and forfeitures previously accrued, and under laws which no longer had any existence. There could not be any future cases arising under those laws, from the very nature of the case. It is true that, upon a question of real doubt as to the meaning of a particular statute (which, however, is not this case), a legislative construction, if deliberately given, is entitled to much weight, although even then it is not conclusive upon the judicial tribunals. See Sedg. St. & Const. Law, 252, 253; Cooley, Const. Lim. 94; Coutant *v.* People, 11 Wend. 511, 513.

(2) The act of February 18, 1867, is in the nature of an ex post facto law."

*United States* v. *Mammoth Oil Co.*, 5 Fed. (2d) 330, at 353.

"Little weight can be attached to any declaration of policy by Congress a considerable time after the act was passed, especially in view of the fact that reports concerning fraud surrounding the lease reached the ear of Congress, and disturbed the equilibrium of that body, perhaps justly so, because of having no way to legally determine the matter in which it was deeply concerned. That function is vested in the courts. Koshkonong *v.* Burton, 104 U. S. 668–678 (26 L. Ed. 886).

"When counsel, in Ogden *v.* Blackledge, 2 Cranch, 272, 277, announced that to declare what the law is, or has been, is a judicial power, to declare what the law shall be is legislative, and that one of the fundamental principles of all our governments is that the legislative power shall be separated from the judicial, this court interrupted them with the observation that it was unnecessary to argue that point.' "

*Rockhold* v. *Canton Masonic Mut. Ben. Soc.*, (Ill.) 21 N. E. 794, in which the Court held for the defendant in an action to recover a sum claimed to be due upon beneficiary's certificate of membership issued by the defendant to the plaintiff. The legislative Act authorized the formation of corporations not for pecuniary profit excluding therefrom corporations for the purposes of banking and insurance. Another Act regulating life insurance made no exception in any of its provisions as to any clause of life insurance. By a subsequent enactment the legislature provided:

" 'Associations and societies which are intended to benefit the widows, orphans, heirs, and devisees of deceased members thereof, and where no annual dues or premiums are required, and where the

members shall receive no money as profit or otherwise, shall not be deemed insurance companies.' "

* * * * *

The Court held:

> "It may be conceded that this language is in form expository, but the legislature cannot instruct the judiciary how to construe certain statutes, any more than the judiciary can instruct the legislature what statutes it shall enact. Ogden *v.* Blackledge 2 Cranch 272; Ashey case 4 Pick. 23. But we concede that, in determining the meaning of obscure clauses in statutes, it may often be important to look into other enactments by the same legislature, having reference to the same subject-matter, as showing the sense in which the language was evidently employed; but it is manifest that the enactments of a subsequent legislature, composed of different members, could have no more value in that respect than the acts of any other department of government. There are here no contemporaneous enactments of the general assembly of 1869 having the slightest bearing upon the question of life insurance, nor are there any contemporaneous enactments of the general assembly of 1872 throwing light upon the corporative act of that year. We must therefore assume that the general assembly of 1874 knew what we hold, namely, that insurance by members of benevolent societies of each other upon the assessment plan for the mutual benefit of themselves, or of their respective widows, orphans, heirs, or devisees, is life insurance, within the meaning of the original act of 1869."

*State* v. *Harden* (W. Va.), 58 S. E. 715, at 731, wherein it is stated:

" 'The Legislature cannot authoritatively declare what the law is or has been. That is a judicial function and pertains to the Court.' Lewis' Suth. Stat. Cons. 358, p. 683; Ogden *v.* Blackledge, 2 Cranch (U. S.) 272, 2 L. Ed. 276; South Ottowa *v.* Perkins, 94 U. S. 260, 24 L. Ed. 154; in re Hanley's Estate, 15 Utah, 212, 49 Pac. 829, 62 Am. St. Rep. 926, 931; Ratcliffe *v.* Anderson, 31 Grat. (Va.) 105, 31 Am. Rep. 716, 'It is always competent to change an existing law by a declaratory statute, and, where the statute is only to operate upon future cases, it is no objection to its validity that it assumes the law to have been in the past what it is now declared that it shall be in the future. But the legislative action cannot be made to retroact upon past controversies, and to reverse decisions which the courts, in the exercise of their undoubted authority, have made, for this would not only be the exercise of judicial power, but it would be its exercise in the most objectionable and offensive form, since the Legislature would, in effect, sit as a court of review, to which parties might appeal when dissatisfied with the rulings of the courts.' "

*Baird* v. *Burke County, et al.* (N. Dak.), 205 N. W. 17, at 19–20, involving taxes, wherein the court stated:

"It is too clear for argument that one purpose of chapter 300 was to construe prior legislation. The construction of statutes is distinctly a judicial function; the duty of making the law or of declaring what it shall be is a legislative function. The division of powers of government into legislative, executive, and judicial, lies at the very foundation of our constitutional system. It has been the belief of constitutional lawyers, as it was of those who laid the foundations of the govern-

ment, that such separation of powers was wise and best calculated to preserve the liberty of the individual against unwarranted encroachments. Each branch under this constitutional theory of departmental division is intrusted with distinct powers and duties; one branch may not assume to perform the functions intrusted to another. The executive, although possessing the power of veto, cannot legislate; the Legislature possesses no judicial or executive power and may not undertake either to enforce existing laws or to declare their meaning so as to bind the executive or the judiciary; and the judiciary possesses no power, either of legislation or of executive administration of existing laws. Cooley's Constitutional Limitations (7th Ed.) 136–140. See, also, People *v.* Board, 16 N. Y. 424; Weisberg *v.* Weisberg, 112 App. Div. 231, 98 N. Y. S. 260. We are constrained to the conclusion, therefore, that the action of the Legislature of 1923, purporting to construe the statutes of 1917 and 1919 as a blunder, in attempting to give a meaning to words contrary to their ordinary and natural import, and in impliedly criticizing prior Legislatures, is of no effect, and not binding upon any other branch of the government, or upon this court. 12 C.J. 811. To hold otherwise would be to exalt the Legislature above the other departments of government, to make it supreme, and in a large measure put an end to the security of liberty and property."

*State* v. *Parsons*, (Iowa) 220 N.W. 328, at 331, wherein the court stated:

"However, the Legislature has no power to direct the judiciary in the interpretation of existing statutes. State *v.* Schlenker, 112 Iowa, 642,

84 N.W. 698, 51 L.R.A. 347, 84 Am. St. Rep. 360. While a legislative construction of an act is entitled to due consideration from the courts, it is in no sense binding on the courts."

*In re Coburn*, (Cal.) 131 Pac. 352, at 355:

> "In 1891 the Legislature added section 1767,—which declares that 'the phrases "incompetent," "mentally incompetent," and "incapable," as used in this chapter, shall be construed to mean any person, who, though not insane, is, by reason of old age, disease, weakness of mind, or from any other cause, unable, unassisted to properly manage and take care of himself or his property, and by reason thereof, would be likely to be deceived or imposed upon by artful or designing persons.'
>
> * * *
>
> The weight of authority supports what we think to be the true rule, i.e., that such declaratory or defining statutes are to be upheld, except with regard to past transactions, as an exercise of the legislative power to enact a law for the future."

*Macartney* v. *Shipherd*, (Ore.) 117 Pac. 814, at 817, holding unconstitutional an act which recited that certain code sections had created doubts whether the time to take an appeal ran from entry of judgment or of order granting or denying a new trial, and which provided appeals filed within six months after denial of motion for a new trial should be validated. The court stated:

> "In Griffin *v.* Cunningham, 20 Grat. (Va.) 31, the Supreme Court of Virginia quotes with approval the language of Judge Cooley as follows:

'To declare what the law is or has been is judicial power; to declare what the law shall be is legislative.' "

*People* v. *Ganly*, 156 N. Y. S. 670, at 674–5, involving a question as to whether a statute requiring county clerks to pay fees to the treasury of the State of New York applied to a certain county. The court stated:

> "It is urged, however, that the Legislature has given a different construction to the acts above referred to, by adopting in 1915 an amendment to section 103 of the Executive Law, by which the words 'Bronx County' are actually written into the act.
>
> * * *
>
> "The most that can be said of the act is that, even if the Legislature of 1915 had construed the act of 1909 in a contrary sense to that which we adopt, that construction would not be of binding force, for it is the courts who must finally decide the proper meaning an construction of statutes."

*Merlo* v. *Johnston City & Big Muddy Coal & Mining Co.* (Ill.), 101 N. E. 525, at 527, wherein it is stated:

> "Whether a given act of the Legislature repeals a former one, and, if so, to what extent, is a judicial question, and a legislative declaration that an act is or is not repealed is only a declaration of the legislature upon a judicial question, which is not binding on the courts."

*United States* v. *Claflin*, 97 U. S. 546, at 548–9, wherein it is stated:

"In sect. 5596 it was thus enacted:

'All acts of Congress passed prior to said first day of December, 1873, any portion of which is embraced in any section of said revision, are hereby repealed, and the section applicable thereto shall be in force in lieu therof; all parts of such acts not contained in such revision having been repealed or superseded by subsequent acts, or not being general or permanent in their nature.'

"As a portion of the act of 1823 was carried into the Revised Statutes (see sect. 3099), and the second section was not, that section was covered by the repealing clause, unless it had been repealed before. But that clause indicates a belief on the part of Congress that it had been previously repealed, and, doubtless, that it was repealed by the act of 1866. The indication is found in the words that declare all parts of acts not contained in the revision, but other portions of which are, to have been repealed or superseded by subsequent acts. This, however, though entitled to great respect, ought not to be considered as more than an expression of opinion or a recital of belief. It is *not in the form of an enactment.* It is not a declaration of congressional will. It is not a rule for the future. It certainly is not conclusive that the second section was repealed or superseded by the act of 1866, or by any other act prior to the enactment of the revision. Whether a statute was repealed by a later one is a judicial, not a legislative question. And even a declaratory act, or an act directing how a former act shall be construed, is inoperative on the past, though controlling in future. *Postmaster-General* v. *Early,* 12 Wheat. 136." (Italics ours)

*The Governor* v. *Porter,* 24 Tenn. (5 Humph.) 164, at 166–8, wherein it is stated:

"By the 1st section it is enacted 'that the 1st and 2d sections of said act (referring to the act of 1835), which require bonds to be executed by sheriffs and their securities for the proper collection and payment of the State and county revenue, shall be construed to require said bonds to be given hereafter every year.'

* * *

"To the legislature belongs the power of enacting such laws, within the limits of the constitution, as the policy of society and its varying interests may seem to require. But, after their enactment, it is then the province of the judiciary to ascertain their meaning, and determine upon their construction. Any other doctrine would destroy the checks contained in the Constitution against the abuse of power, and tend to a concentration of all power in a single department of the government. It is unnecessary to dwell upon this point farther than merely to say the Legislature of 1835 enacted a law in reference to the collection of the revenue. That of 1839–40, *without repealing that law or enacting a different one* so far as the first section of the act is concerned, which we are now considering, which it was perfectly competent for them to do, undertake to say what is the meaning of the former law, and to decide upon its construction. This we think was beyond their power."

*Haley* v. *City of Philadelphia*, 68 Penn. 45, at 47:

"The only other question which can arise upon this record, is as to the effect of the Act of April 21st, 1869, Sec. 9, Pamph. L. 1194. This section is a legislative declaration that the true intent and meaning of the Acts of 1867 and 1868 were, 'that

no interest shall be allowed on damages for ground taken up to the time of their payment on the issue of any warrant for their payment by the city of Philadelphia.' * * * It would be monstrous to maintain that where the words and intention of an act were so plain that no court had ever been appealed to for the purpose of declaring their meaning, it was therefore in the power of the legislature by a restrospective law to put a construction upon them contrary to their obvious letter and spirit. Reiser *v.* The William Tell Saving Fund Association, 3 Wright 137, is an authority in point against such a doctrine. An expository Act of Assembly is destitute of retroactive force, because it is an act of judicial power, and is in contravention of the 9th section of the 9th article of the Constitution, which declares that no man can be deprived of his property, 'unless by the judgment of his peers or the law of the land.' "

*Planters' Bank of Tennessee* v. *Black*, *10 Miss.* (11 Smedes & M.) 43, at 50–1:

"To obviate the force of this statute, the defendants rely on an act approved 19th February, 1846, entitled an act to settle the construction of the 13th section of an act entitled an act to amend the several acts of limitations, approved February 24th, 1844. This statute directs, 'that the 13th section of the above cited act shall not be so construed, as to affect the right or impair the lien of any judgment where the plaintiff therein, or other person interested, has been prevented from levying his execution by reason of a preceding levy, under and by virtue of an execution emanating on a junior judgment; and when the

officer thus levying such junior execution fails, refuses or neglects to sell the property thus levied on, on or before the 24th February instant, provided said judgment has been enrolled according to existing laws.'

"It is insisted in argument that this law is unconstitutional. The right of the legislature to repeal, alter or modify a law, is not questioned; but it is urged, that, upon its face, this is a legislative construction of a previous statute, and that the right to construe laws belongs to the judicial department of the government. Nothing is more clear than that it is beyond the scope of legislative authority, to put a construction upon its laws which can be obligatory upon the courts. The province of the legislature is to enact laws, that of the court to expound or interpret them."

*Commonwealth* v. *Warwick*, (Pa.) 33 Atl. 373, 375. A statute provided when a legislative officer should be incapable of holding office his place should be filled by a joint vote of the city councils until the next city election. A subsequent act provided that the words "next city election" should be construed to mean the election at which the voters would elect a successor in office had no vacancy occurred therein. The court held the later statute unconstitutional, stating:

"The practical effect of the act of 1867 in the present case would be to compel this court of 'construe' the expression 'the next city election,' used in the act of 1854, to mean not the 'next' but the 'next but one.' It was clearly beyond the legislative power to thus usurp judicial functions, or to distort language."

*Titusville Iron Works* v. *Keystone Oil Co.*, (Pa.) 15 Atl. 917, holding nugatory as an usurpation of a judicial function a statute declaring that provisions of prior acts involving mechanics' liens shall be construed to include claims for all labor done "no matter at whose instance or upon whose credit it was done."

*Ogden* v. *Nash*, 3 No. Car. 266 (2 Hay. 277), where an act provided that a prior statute prescribing the limitation period for making claims against estates of decedents has continued and shall continue in force. The court stated:

> "The separation in these powers has been deemed by the people of almost all the States, as essential to liberty And the question here is, does it belong to the judiciary to decide upon laws when made, and the extent and operation of them; or to the Legislature? If it belongs to the judiciary then the matter decided by this act, namely, whether the act of 1789 be a repeal of the 9th section of 1715, is a judicial matter and not a legislative one. The determination is made by a branch of government, not authorized by the constitution to make it; and is therefore in my judgment void."

*Houston* v. *Bogle*, 32 No. Car. 357 (10 Ire 496), wherein the court stated:

> "It is settled that the Legislature cannot pass any declaratory law or act declaring what the law was before its passage, so as to give it any binding weight with the courts."

*Lincoln Building and Saving Association* v. *Graham*, 7 Neb. (Brown) 173, at 179–80, involving usury statutes, wherein the court stated:

"Section three legalizes 'all contracts and loans made by any corporation or association already formed,' under chapter XXV of the Revised Statutes of 1866, with any member thereof, and section four defines what 'shall be deemed in law a waiver of anything in such contract or loan that might be deemed usurious in the same under the laws of this state, at the time the same was made and securities given.'

* * *

"The two sections referred to are not in the nature of a declaratory statute, nor are they in the nature of a curative act; but they purport to be an interpretation of former laws, and are substantially in the nature of a mandate to the courts to construe and apply the former laws, not according to judicial, but according to legislative judgment. * * * the powers of the legislature are to enact laws, not to expound them; and the powers of the courts are to interpret the law, declare what it is, and apply it to cases as they arise."

*Gough* v. *Pratt*, 9 Maryland 526, at 532–3, wherein the court stated:

"It has been said, by the appellee, the Circuit Court of the United States, in the case referred to, were wrong in holding a security given for a gambling debt to be void in this State. He contends the decision was based upon the idea that the statute of *9th Anne, ch.* 14, was then in force here, when, in fact, it was not. The act of 1813 ch. 84, he says, does not make *void* such securities as the present, but simply provides, they shall not be 'demandable or recoverable before any court of justice;' and not being absolutely *void*,

but only *voidable*, if resisted in proper time, a court of equity, after a judgment at law, could not prevent the claimant from demanding payment.

* * *

"But we see nothing in this, or any previous law, which, either in express terms or by necessary implication, repeals the statute of *Anne*. Should it be conceded the laws relate to the same matters, they are not so inconsistent as to require that the statute should be considered as repealed by our legislation. And in reference to whether a suit could or could not be maintained upon a security given for a gambling consideration prior to the act of 1813, if the proviso of that act has any relation to such securities, it can only be regarded as a legislative interpretation of what was the previous law on the subject; which interpretation is not binding upon us, unless we think it correct, which we certainly do not."

*City of New Orleans* v. *Louisiana Mutual Insurance Company*, 26 La. Ann. 499, involving tax statutes. The state court had held in a prior case that under the state revenue law of 1872 an insurance company paying a state license tax is also liable for a municipal tax on "merchandise, capital and money at interest", in spite of a section of the License Tax Act providing "no insurance company whose license tax shall be $1,000. shall be liable to any assessment—state, parish or municipal throughout the state—other than that imposed by this article and section 6 of this act." Act No. 57 of the 1874 Louisiana General Laws provided:

"SECTION 1. *Be it enacted by the Senate and House of Representatives of the State of Louisiana in General Assembly convened*, That the true intent and meaning of the fifteenth paragraph of the first section of the revenue law of 1872, act No. 14, approved March 5, 1872, is that the payment of one thousand dollars tax by and insurance company incorporated under and doing business by or under the laws of this State, shall be deemed a full quittance for all taxes imposed by State, parish or municipal authority for the year for which said one thousand dollars license is paid, except taxes on real estate owned by said company.

SEC. 2. *Be it further enacted, etc.*, That this act shall take effect from and after its passage."

The court followed the decision in the previous case in spite of the amendatory act, stating:

"If the act of 1874 was to interpret the acts of 1871 and 1872, as seems to be its purpose, it is unconstitutional, because trenching upon the jurisdiction of the judiciary. To interpret laws is not within the powers of the General Assembly; it is not a legislative, but a judicial function.

"It is therefore ordered that the judgment appealed from be affirmed with costs."

Other cases of interest are:

*In re Handley's Estate* (Utah), 49 Pac. 829 at 831;

*Respublica* v. *M'Clean*, 4 Yeates 406;

*Reiser* v. *William Tell Saving Fund Association*, 39 Pa. St. 137, at 144.

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# In the Supreme Court of the United States

OCTOBER TERM, 1929

FAWCUS MACHINE COMPANY, PETITIONER

*v.*

THE UNITED STATES

*ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS*

**MEMORANDUM FOR THE UNITED STATES**

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106693—30

# In the Supreme Court of the United States

OCTOBER TERM, 1929

No. 625

FAWCUS MACHINE COMPANY, PETITIONER

*v.*

THE UNITED STATES

*ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS*

## MEMORANDUM FOR THE UNITED STATES

### OPINION BELOW

The memorandum opinion of the Court of Claims (R. 28) has not yet been officially reported.

### JURISDICTION

The judgment sought to be reviewed was entered on November 4, 1929. (R. 28.) The petition for certiorari was filed February 4, 1930. (R. 28.) The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925.

## QUESTION PRESENTED

In computing the invested capital for the year 1919, of a corporation whose books of account are kept on the accrual basis, should its invested capital as at the close of the year 1918 be reduced by the amount of income and profits taxes imposed for the year 1918 by the Revenue Act of 1918 which was enacted on February 24, 1919?

## STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Revenue Act of 1918 (c. 18, 40 Stat. 1057, 1092), are as follows:

> SEC. 326. (a) That as used in this title the term "invested capital" for any year means (except as provided in subdivisions (b) and (c) of this section);
>
> (1) Actual cash bona fide paid in for stock or shares;
>
> (2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, * * *;
>
> (3) Paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year;
>
> * * * * *
>
> (b) As used in this title the term "invested capital" does not include borrowed capital.
>
> * * * * *
>
> (d) The invested capital for any period shall be the average invested capital for such period * * *.

Section 1207 of the Revenue Act of 1926 (c. 27, 44 Stat. 9, 129) provides as follows:

> SEC. 1207. The computation of invested capital for any taxable year under the Revenue Act of 1917, the Revenue Act of 1918, and the Revenue Act of 1921, shall be considered as having been correctly made, so far as relating to the inclusion in invested capital for such year of income, war-profits, or excess-profits taxes for the preceding year, if made in accordance with the regulations in force in respect of such taxable year applicable to the relationship between invested capital of one year and taxes for the preceding year.

On February 17, 1919, the Treasury Department promulgated Treasury Decision 2791, which provided as follows:

> For the purpose of determining invested capital under Title II of the act of October 3, 1917, income and excess-profits taxes shall be deemed to have been paid out of the net income for the taxable year for which such taxes are levied. Amounts payable on account of income and excess-profits taxes for any year may be included in computing surplus and undivided profits for the succeeding year only for the proportionate part of the year represented by the period of time between the close of the taxable year and the date or dates upon which such taxes become due and payable.

The substance of this Treasury Decision was included in Article 845 of Regulations 45, issued under the Revenue Act of 1918.

STATEMENT

Petitioner is a Pennsylvania corporation and was engaged in business during the years 1918 and 1919. (R. 24, 26.) It kept its books of account and filed its income and profits tax returns on the accrual basis. (R. 26.) In its income and profits tax return for the year ended December 31, 1919, petitioner did not make any reduction in its invested capital for that year on account of income and profits tax assessed and paid in 1919 for the year 1918. (R. 25, 26.) During the taxable year 1919 at the time each installment of 1918 income and profits taxes of petitioner became due and payable, it had on hand surplus or undivided profits earned during the taxable year 1919, more than sufficient to pay such installment. (R. 26.)

The Commissioner of Internal Revenue, in auditing the petitioner's 1919 return, determined that its invested capital for the year 1919 should be reduced by the amount of taxes on income and profits earned in the year 1918, as of the dates in 1919 when the respective installments of taxes became due and were paid. (R. 26.) This was accomplished by determining the average deduction for the year and reducing earned surplus as of January 1, 1919, by that amount. (R. 26.)

The petitioner claims a refund of $1,597.85 alleged to have been overpaid for the year ended

December 31, 1919, and contends that the Commissioner of Internal Revenue was in error in reducing its invested capital for one year on account of income and profits taxes for the preceding year.

**ARGUMENT**

The Government does not oppose the petition for certiorari in this case.

If the petitioner's income and profits taxes for the year 1918 accrued during the year 1918, there is no contention that the reduction of the petitioner's invested capital was not properly made. The petitioner's position is that these taxes could not have accrued during 1918, because the Revenue Act of 1918 was not enacted until February 24, 1919, and the petitioner further contends that if the taxes did not accrue in 1918 they could not be deducted from invested capital for the following year.

The Court of Claims in its memorandum opinion in this case (R. 28) said that the question was controlled by four decisions, which it cited. These cases are *United States* v. *Yale & Towne Mfg. Co.* (*United States* v. *Anderson*), 269 U. S. 422; *Nichols* v. *Sylvester Co.*, 16 F. (2d) 98 (C. C. A. 1st), certiorari denied, 273 U. S. 760; *Bowers* v. *Kaufman & Co.*, 18 F. (2d) 69 (C. C. A. 2d); *Appeal of Russell Wheel & Foundry Co.*, 3 B. T. A. 1168.

We do not feel that the first and third of these cases, at least, are decisive of the point made by petitioner. They decide only that a tax accrues during the year for which it is levied, when the Revenue Act levying the tax is passed before the

end of the year for which the tax is levied. They do not consider the problem of when the taxes on 1918 income and profits accrued, in view of the fact that the Revenue Act of 1918 was not passed until February 24, 1919. The question seems to be involved in *Nicholas* v. *Sylvester Co., supra*, but the precise point was not considered in the opinion of the court. *Appeal of Russell Wheel & Foundry Co.*, also cited by the Court of Claims, is referred to, *infra*, p. 8.

In *United States* v. *Norwich & W. R. Co.*, 16 F. (2d) 944, the District Court of Massachusetts adopted substantially the view which the petitioner now presents, and the Government did not appeal from its decision.

But we do not admit that the contentions of the petitioner are correct. Until February 24, 1919, the Revenue Act of 1917 was in force. The effect of the Revenue Act of 1918 was simply to amend the Revenue Act of 1917. It thus seems arguable that as the taxes under the 1917 Act for the year 1918 accrued in 1918, and as this Act was later amended by retroactive legislation, the tax under the Act as amended may be treated as if it accrued in place of the tax previously provided for.

Revenue Acts may be, and they frequently have been, amended by retroactive legislation after the year for which the tax is levied. (*Cf.* the dissenting opinion in *Untermyer* v. *Anderson*, 276 U. S. 440, 447–448.) The amendment may decrease or increase the tax. Nevertheless, such tax as may be levied must be treated as if it accrued in the year for

which it is levied (where books are kept on the accrual basis) if income is to be clearly reflected. Books of account may readily be amended accordingly. We submit, therefore, that the date of the passage of the Act is immaterial.

*Shuster & Co., Inc.*, v. *Williams, Collector*, 283 Fed. 115 (C. C. A. 7th), relied upon by the petitioner, seems distinguishable. There a State law was passed in 1919 levying a soldiers' bonus tax upon 1918 incomes. It was held by the court that the tax did not accrue until 1919, but in that case the tax imposed was not simply an amendment of an already existing tax but was a wholly independent tax, having no counterpart, either in earlier or in later taxing legislation.

Moreover, the method of computing invested capital followed in this case was that prescribed by Treasury Decision 2791 (p. 3, *supra*). The statute contained no provision which this Decision contravened. We submit that the Decision laid down a reasonable rule for the treatment of taxes in the calculation of invested capital, a matter which was not particularly adverted to in the statute and which was within the province of the Commissioner's discretion. We contend that the matter should be governed by this regulation and that the question when the taxes accrued is not necessarily involved.

In Section 1207 (p. 3, *supra*) of the Revenue Act of 1926, Congress made specific reference to the method of computing invested capital under

the Revenue Act of 1918. The Board of Tax Appeals, in one of the decisions relied on by the Court of Claims in the instant case, took the view that the action of Congress in passing this Section was a direct approval of the method followed in the instant case. *Appeal of Russell Wheel & Foundry Co.*, 3 B. T. A. 1168. But it can not be said that there is no force in the petitioner's contention that this section should not be so construed, and in the further contention that if it is to be so construed there may be doubts as to its constitutionality.

A very large number of cases are now pending in the courts, before the Board of Tax Appeals, and in the Bureau of Internal Revenue in which the present question is involved. A decision by this Court in the present case will facilitate the disposition of these pending cases.

Respectfully submitted.

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No. 40

# In the Supreme Court of the United States

OCTOBER TERM, 1930

FAWCUS MACHINE COMPANY, PETITIONER

*v.*

THE UNITED STATES

*ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS*

**BRIEF FOR THE UNITED STATES**

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THE UNITED STATES

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*ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS*

---

## BRIEF FOR THE UNITED STATES

---

### OPINION BELOW

The memorandum opinion of the Court of Claims (R. 28) has not been officially reported. The decision is noted in 68 C. Cls. 784.

### JURISDICTION

The judgment of the Court of Claims was entered on November 4, 1929. (R. 28.) The petition for certiorari was filed February 4, 1930. (R. 28.) Certiorari was granted April 21, 1930 (R. 29), 281 U. S. 711. The jurisdiction of this Court rests on Section 3 (b) of the Act of February 13, 1925.

27106—30——1

## QUESTION PRESENTED

In computing the invested capital for the year 1919 of a corporation whose books of account are kept on the accrual basis, should its invested capital as at the close of the year 1918 be reduced by the amount of income and profits taxes imposed for the year 1918 by the Revenue Act of 1918, which was enacted on February 24, 1919?

## STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix, *infra*, pp. 19–20.

## STATEMENT

Petitioner is a Pennsylvania corporation and was engaged in business during the years 1918 and 1919. (R. 24, 25.) It kept its books of account and filed its income and profits tax returns on the accrual basis. (R. 26.) In its income and profits tax return for the year ended December 31, 1919, petitioner made no reduction in its invested capital for that year on account of income and profits taxes assessed and paid in 1919 for the year 1918. (R. 25.) During the year 1919, at the time each installment of the 1918 taxes became payable, petitioner had on hand profits earned during 1919 more than sufficient to pay such installment.

The Commissioner of Internal Revenue, in auditing the petitioner's 1919 return, determined that its invested capital for the year 1919 should be re-

duced by the amount of taxes on income and profits earned in the year 1918, as of the dates in 1919 when the respective installments of taxes became due and were paid. (R. 26.) This was accomplished by determining the average deduction for the year 1919 and reducing the earned surplus as of January 1, 1919, by that amount. (R. 26.)

The petitioner claims a refund of $1,597.85 alleged to have been overpaid for the year ended December 31, 1919, and contends that the Commissioner of Internal Revenue was in error in reducing its invested capital for the year 1919 on account of income and profits taxes for the preceding year.

## SUMMARY OF ARGUMENT

Article 845 of Treasury Regulations 45, under which petitioner's invested capital for the year 1919 was computed, is a departmental ruling upon a question raised by, but not specifically adverted to in the Revenue Act of 1918, and as such should not be held invalid unless clearly unreasonable. Article 845 has received the implied approval of Congress in the enactment of the Revenue Act of 1921. Although not binding upon this Court, such implied approval is entitled to great consideration.

The exclusion from invested capital for the year 1919 of income and profits taxes for the year 1918 is reasonable and in accordance with good accounting practice, where, as here, the taxpayer's books are kept on the accrual basis. The Revenue Act of 1918 was in effect an amendment to the Revenue

Act of October 3, 1917. Consequently, at the close of the year 1918 the taxpayer was under an accrued liability for income and profits taxes for that year computed under the Act of 1917; this accrued liability should have been adjusted to conform to the rates prescribed by the Act of 1918, in order that income might be correctly reflected. Since the petitioner's return for 1919 was not filed until March, 1920, there was ample opportunity for making such adjustment.

Section 1207 of the Revenue Act of 1926 has been interpreted by the Board of Tax Appeals to be an express ratification of Article 845 and the computations of invested capital made by the Commissioner pursuant thereto. Although we do not support this construction, we submit that the section is not unconstitutional if so construed.

## ARGUMENT

### I

### ARTICLE 845 OF REGULATIONS 45 SHOULD NOT BE HELD INVALID UNLESS CLEARLY UNREASONABLE

The concept of "invested capital" as an element in the computation of the excess profits tax was purely a legislative one. There can be no doubt that Congress might have made express provision for the exclusion of taxes from invested capital. But detailed provisions as to each item which should be or should not be included in invested cap-

ital would have made the statute unnecessarily long and complex. Instead, Congress established a definition of invested capital in general terms. Section 326 (a) of the Revenue Act of 1918 (*infra*, p. 19), provided:

> That as used in this title the term "invested capital" for any year means * * *;
>
> (1) Actual cash bona fide paid in for stock or shares;
>
> (2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, * * *;
>
> (3) Paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year;

Because of the broadness and generality of this definition, especially as to the meaning of "paid-in or earned surplus and undivided profits," the Commissioner of Internal Revenue was obliged to formulate regulations as to the details of its administration. Treasury Regulations 45 were promulgated on April 17, 1919, to govern the administration of the Revenue Act of 1918. Article 845 of those Regulations [1] (*infra*, pp. 19–20) provided that in computing invested capital—

> federal income * * * taxes are deemed to have been paid out of the net income of the taxable year for which they are levied.

---

[1] This article was patterned upon and substantially identical with Treasury Decision 2791, promulgated February 17, 1919, under Title II of the Revenue Act of October 3, 1917.

It was further provided that amounts payable on account of such taxes might be included in invested capital until the taxes become due and payable. The computation of invested capital in the present case was made in accordance with this Article.

Power to make regulations for the enforcement of the Act was expressly conferred by Section 1309 of the Act. (*Infra*, p. 19.) The Commissioner thus had "power to fill up the details" as to the administration of the statute in matters not expressly provided for in the statute, and his regulations are valid if reasonable and not inconsistent with the law. Cf. *United States* v. *Grimaud*, 220 U. S. 506, 517; *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, 349; *International Railway Co.* v. *Davidson*, 257 U. S. 506, 514.

When the terms of a statute are doubtful or ambiguous, the contemporaneous construction of those charged with their administration is entitled to great respect. This principle of interpretation has been too firmly established by the decisions of this Court to require extended discussion. *Edwards* v. *Darby*, 12 Wheat. 206; *United States* v. *Moore*, 95 U. S. 760; *National Lead Company* v. *United States*, 252 U. S. 140; *Brewster* v. *Gage*, 280 U. S. 327. It is not altered by the fact that there may be other and equally reasonable interpretations. Cf. *Brown* v. *United States*, 113 U. S. 568, 570.

Section 326 (a) (3) of the Revenue Act of 1918 is sufficiently ambiguous to justify the invocation

of this rule for purposes of guidance. The question of the inclusion or exclusion of taxes for the preceding year in the computation of earned surplus is not adverted to, either directly or indirectly, in the statute. The practice of the Commissioner has been uniform, as is shown by Treasury Decision 2791, Article 845 of Regulations 45, and Article 845 of Regulations 62 covering the corresponding section of the Revenue Act of 1921. This departmental interpretation of the statute must stand unless unwarranted and unreasonable.

Greater force is lent to the rule in the instant case by reason of the fact that the very provisions of the Revenue Act of 1918 to which Article 845 was directed were reenacted by Congress in Section 326 of the Revenue Act of 1921. (Although the precise situation here involved could not arise under that Act, as it was passed before the end of the first calendar year to which it applied, there might arise under it the analogous question of its application to a fiscal year ending sometime during 1921, before its passage on November 23, 1921.) We submit that this reenactment in 1921 is indicative of Congressional approval of the regulation as applied to taxes levied under the 1918 Act. This Court has repeatedly recognized the value of subsequent legislation as an aid to the interpretation of ambiguous or doubtful provisions of an earlier statute under consideration.

In the case of *Bailey* v. *Clark,* 21 Wall. 284, which involved the construction of the word "capi-

tal" as used in the Revenue Act of 1866, the Court referred to the Act of 1872, in which the word was expressly defined, and said (p. 288):

> This enactment was evidently intended to remove any doubt previously existing as to the meaning of the statute and declare its true construction and meaning. Had it been intended to apply only to cases subsequently arising it would undoubtedly have so provided in terms.

It is true that the Act of 1921 does not attempt to define "invested capital" more precisely than does the Act of 1918. But at the time of the enactment of the later Act, Article 845 of Regulations 45 was in force and had been enforced for two years. Consequently, Congress must be presumed to have legislated in the light of that Article and to have sanctioned the departmental construction of the earlier Act. Cf. *Copper Queen Mining Co.* v. *Arizona Board*, 206 U. S. 474, 479.

Where the meaning of the reenactment is in question it is held that the executive construction is to be read into and made a part of the statute with the same force and effect as if specifically incorporated therein. *National Lead Company* v. *United States, supra; Brewster* v. *Gage, supra.* In the instant case we contend merely that the reenactment is persuasive evidence of the intent of Congress in the earlier Act. It was so held, as to another regulation under the 1918 Act, in *Schweizer*

v. *Mager*, 297 Fed. 334 (N. D. Ill.). See also *Johnson* v. *Southern Pacific Co.*, 196 U. S. 1, 21.

We consequently submit that the regulation should not be held invalid unless it is clearly unreasonable.

## II

### ARTICLE 845 OF REGULATIONS 45 IS REASONABLE, IN ACCORDANCE WITH GOOD ACCOUNTING PRACTICE, AND NOT IN CONFLICT WITH THE STATUTE OR THE DECISIONS OF THE COURTS

The taxpayer in the case at bar kept its books, during all the years pertinent to this action, on the accrual basis (R. 26—Finding VII), and its excess-profits tax return for the year 1919 was prepared on the same basis, as required by the provisions of the statute. In computing the tax for 1919 the Commissioner allowed taxes for 1918 to be included in invested capital only until such time as they were actually paid. We maintain that the Commissioner could validly have required that in the computation of invested capital for 1919 the entire amount of all taxes on 1918 income be deducted. If so, the regulation in question, which required the deduction of only part of the amount of those taxes, can not be objected to by the taxpayer.

The Revenue Acts require that the tax return shall be made on a basis which clearly reflects income. (Cf. Revenue Act of 1918, Section 212 (b).) Income can not be correctly reflected unless all costs

of obtaining that income are deducted therefrom. The principle is stated in Scott, *Theory of Accounts,* Vol. I, p. 50, as follows:

> In order that the statement showing a balance of net income or net loss may be truly representative it is necessary for the incomes and expenses shown to refer to the same operations.

When the accrual method of accounting is followed, all major items must be treated with reference to the accrual dates. If income is entered on the books as soon as it has accrued, and the expenses incident to the earning of such income are not entered until due and payable, or until actually paid, the net income for the accounting period is not accurately reflected. We again quote from Scott, *Theory of Accounts,* p. 52:

> A second rule may be stated without further argument. It is that from the total incomes of any period there should be deducted all expenses which are costs of obtaining those incomes. Any item which is a cost of obtaining income of the period is a current cost or operating expense.

See to the same effect *United States* v. *Anderson,* 269 U. S. 422, 440.

In one sense it is arguable that a tax is not an operating expense, since it is not an item of cost which is voluntarily incurred and can be allocated to specific production items. On the other hand, if a tax is to be allocated to any one accounting period rather than to another, it should be allocated to the

period in which was earned the income on which it was imposed, where accounts are kept on the accrual basis. A tax on income is recognized as an expense of production by practising accountants. See Montgomery and Staub, *Auditing Principles* (1923), p. 308:

> The deductions from gross income should include all income taxes. A corporation can not claim to have accumulated any net income in any year until provision is made for taxes accrued or payable to the United States, based on net income for the same year. * * * This principle holds good whether or not the taxes or other charges have been paid.

The principle that a tax must be considered to accrue at the termination of the period for which it is imposed was expressly recognized by this Court in the case of *United States* v. *Anderson,* 269 U. S. 422. This decision was followed in the cases of *Nichols* v. *Sylvester Co.,* 16 F. (2d) 98 (C. C. A. 1st), certiorari denied, 273 U. S. 760; *Bowers* v. *Kaufmann & Co.,* 18 F. (2d) 69 (C. C. A. 2d); and *W. S. Bogle & Co.* v. *Commissioner,* 26 F. (2d) 771 (C. C. A. 7th).[2]

Petitioner attempts to distinguish the *Anderson* (or *Towne*) *case* on the ground that excess-profits taxes for the year 1918 can not be deemed to have accrued in that year because the Revenue Act of

[2] In *United States* v. *Norwich & W. R. Co.,* 16 F. (2d) 944, the District Court for Massachusetts adopted substantially the view which the petitioner now presents.

1918 was not enacted until February 24, 1919. The Act of 1918 is in terms retroactive and applicable to the year 1918. Section 301 (a) provides for the collection of an excess-profits tax for the year 1918 "in lieu of the tax imposed by Title II of the Revenue Act of 1917." The effect of the 1918 Act is in this respect to amend the Act of 1917; the basis of the tax is substantially identical in both statutes, the only difference being in the rates.

At the end of the calendar year 1918 the Act of 1917 was in effect. It follows from the foregoing discussion of the accrual method of accounting, and from the decision of this Court in the *Anderson case* that on December 31, 1918, petitioner was subject to an accrued liability under the 1917 Act for excess-profits taxes for 1918. Such accrued liability would have been a proper deduction from invested capital as of January 1, 1919, had the Act of 1918 not been adopted prior to the filing of the tax return.

The 1917 Act having been amended by retroactive legislation, the tax under the Act as amended may properly be treated as accruing in place of the tax previously provided for. A Revenue Act may be, and frequently has been, amended by retroactive legislation after the year for which the tax is levied. In fact, entirely new tax legislation has frequently been made retroactive. (Cf. cases cited in dissenting opinion in *Untermyer* v. *Anderson,* 276 U. S. 440, 446–454.) Regardless of whether it is technically correct to regard the tax in question

as accruing in 1918, the situation is one in which the Commissioner could reasonably regard the 1918 tax as having the same effect on 1919 invested capital as the 1919 tax did on 1920 invested capital.

From a practical standpoint there is no objection to the method established by the Commissioner. The Revenue Act of 1918 was enacted on February 24, 1919. Regulations 45 were promulgated on April 17, 1919. Petitioner's tax return was not filed until approximately March 15, 1920. Amended returns were filed in June, 1921, and in January, 1922. (R. 25—Finding II.) At the close of the year 1918 petitioner knew that it would be required to pay income and excess-profits taxes for that year under the Act of 1917. The fact that the amount of the tax as finally established was different from that originally contemplated should not control the case.

Since the Act of 1918 was retroactive by its express terms, there can be no objection to construing it as being retroactive in this respect, especially since the result of such construction is to require taxes to be treated, for purposes of accounting, in accordance with established accounting principles.

The petitioner quotes from the report of the Senate Finance Committee on the 1918 Revenue Act in an attempt to show that Congress did not contemplate the deduction of income and excess-profits taxes in the computation of invested capital. (Brief, p. 16.) The paragraph quoted relates to determination of net income and has no bearing on

the question here presented. If the Committee was of the opinion that taxes would be deducted in the year in which payable, regardless of whether the taxpayer's books were kept on the cash or the accrual basis, its opinion carries no weight as against this Court's decision in the *Anderson case.* Moreover, nondeductibility for income-tax purposes has no bearing on the question of deduction for excess-profits tax purposes. As this Court said in *Willcuts* v. *Milton Dairy Co.,* 275 U. S. 215, 220:

> The deductions from gross income allowed by that Title [Title II] do not refer to invested capital, surplus, or undivided profits, and its provisions throw no light upon the meaning of those terms as used in Title III providing for an excess-profits tax.

The facts in the instant case are substantially identical with those involved in the case of *Nichols* v. *Sylvester Co.,* 16 F. (2d) 98, *supra.* There the plaintiff contended that the tax due under the retroactive provisions of the Revenue Act of October 3, 1917, for the fiscal year ended June 30, 1917, should be included as part of its invested capital for the fiscal year 1917–1918 until paid on June 14, 1918. The Commissioner had deducted the tax as of December 15, 1917, the date when it became payable under the administrative provisions of the Act. The court sustained the Commissioner's action and expressed the opinion that the tax accrued June 30, 1917 (although the Act had

not then been adopted), and that no part of it should have been included in invested capital for the following fiscal year.

*Schuster & Co., Inc.*, v. *Williams, Collector*, 283 F. 115 (C. C. A. 7th), relied upon by petitioner, seems distinguishable on two grounds. That case involved the Wisconsin Soldiers' Bonus Act, which was passed in 1919 and imposed a tax on the basis of 1918 incomes. The Circuit Court of Appeals held that the tax did not accrue until 1919 (citing *United States* v. *Woodward*, 256 U. S. 632, a decision which was restricted in its application, as this Court pointed out in the *Anderson case*, 269 U. S. 422, 441, *supra*) and that it was not deductible in computing the Federal income tax for 1918. But the Bonus Act was a wholly independent measure, having no counterpart in either earlier or subsequent tax legislation and was not simply an amendment of an existing law, as was the Revenue Act of 1918. Consequently, the taxpayer was under no liability whatsoever in this respect at the close of the year 1918. Furthermore, the Bonus Act did not become law until it had been ratified by popular vote, which did not take place until some months after the Federal income-tax return had been filed.

The *Woodward case, supra*, on which petitioner also relies, is not in point for the reason that, as this Court observed in the *Anderson case*, that case involved an estate tax, and it did not

appear whether the taxpayer kept his books on the accrual basis.

## III

SECTION 1207 OF THE REVENUE ACT OF 1926 HAS BEEN INTERPRETED TO CONSTITUTE EXPRESS RATIFICATION OF THE RULING OF THE COMMISSIONER. AS SO INTERPRETED THIS SECTION IS CONSTITUTIONAL

In Section 1207 of the Revenue Act of 1926 (*infra*, p. 20), Congress expressly ratified the computations of invested capital made by the Commissioner, in so far as they involved the *inclusion* in invested capital for one year of income and profits taxes for the preceding year, "if made in accordance with the regulations in force in respect of such taxable year" applicable to the relationship between those items. Petitioner urges that this section was designed only to relieve the Commissioner of the necessity, under the decision in *United States* v. *Anderson*, *supra*, of collecting additional taxes on the ground that Article 845 was too lenient in permitting the retention of any part of income and profits taxes for the prior year in invested capital for the taxable year. Although we agree with this contention, we point out that it has not been so interpreted.

Prior to the passage of the Act of 1926 and the decision in the *Anderson case*, *supra*, the Board of Tax Appeals, in *Appeal of Guarantee Construction Co.*, 2 B. T. A. 1145, had held Article 845 invalid. This decision was expressly overruled in *Appeal of*

*Russell Wheel & Foundry Co.*, 3 B. T. A. 1168, because of Section 1207.

Since deciding the *Russell Wheel Company case*, the Board of Tax Appeals has rendered more than twenty decisions sustaining the action of the Commissioner in reducing invested capital in accordance with the requirements of Article 845. In each case the Board expressly relied on Section 1207, the *Russell Wheel Company case*, or both. At least ten of these cases involve the same tax years as the instant case.[3] To the same effect is *W. S. Bogle & Co.* v. *Commissioner*, *supra*, in which the court cited both Section 1207 and the *Anderson case*. See also the report of the Conference Committee, p. 21, *infra*.

Although we do not agree with this construction of Section 1207, nevertheless we submit the question for the consideration of the Court, if it be deemed essential to the decision of this case.

To construe Section 1207 as a ratification of the whole of Article 845 and the computations made pursuant thereto does not, we submit, render it unconstitutional. Congress would have had ample power to make specific provision in the Act of 1918 for the calculation of the tax on the basis used by the Commissioner herein, and had power to ratify the Commissioner's interpretation and his acts performed thereunder. *United States* v. *Heinszen &*

[3] See for example *Hutchins Lumber Co.* v. *Commissioner*, 4 B. T. A. 705.

*Company*, 206 U. S. 370; *Rafferty* v. *Smith, Bell & Company*, 257 U. S. 226; *Charlotte Harbor Railway* v. *Welles*, 260 U. S. 8.

*Koshkonong* v. *Burton*, 104 U. S. 668, cited by petitioner as a leading case, is not in point. There the later enactment purported to affect vested contract rights, and was accordingly held unconstitutional.

## CONCLUSION

The judgment of the Court of Claims should be affirmed.

Respectfully submitted.

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DECEMBER, 1930.

## APPENDIX

The pertinent provisions of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1092, 1143, are as follows:

Section 326. (a) That as used in this title the term "invested capital" for any year means (except as provided in subdivisions (b) and (c) of this section):

(1) Actual cash bona fide paid in for stock or shares;

(2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, * * *;

(3) Paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year;

* * * * *.

(b) As used in this title the term "invested capital" does not include borrowed capital.

* * * * *

(d) The invested capital for any period shall be the average invested capital for such period * * *.

SEC. 1309. That the Commissioner, with the approval of the Secretary, is hereby authorized to make all needful rules and regulations for the enforcement of the provisions of this Act.

* * * * *

Article 845 of Regulations 45, issued under the Revenue Act of 1918, provides as follows:

*Surplus and Undivided Profits: Reserve for Income and Excess Profits Taxes.*—For

the purpose of computing invested capital federal income and war profits and excess profits taxes are deemed to have been paid out of the net income of the taxable year for which they are levied. It is immaterial, therefore, whether reserves for the payment of such taxes for the preceding year have been set up or not, or if set up whether such taxes when paid have actually been charged against such reserves. Amounts payable on account of such taxes for the preceding year may be included in the computation of invested capital only until such taxes become due and payable. A deduction from the invested capital as of the beginning of the taxable year must therefore be made for such taxes or any installment thereof, averaged for the proportionate part of the taxable year after the date when the tax or the installment is due and payable. Where as a result of an audit by the Commissioner, or the acceptance of an amended return, or for any other reason, the amount of any such tax for the preceding year is subsequently changed, a corresponding adjustment will be made in the invested capital for the taxable year upon the same basis as if the corrected amount of the tax for the preceding year had been used in the original computation of the invested capital for the taxable year. See articles 1541 and 1542.

Section 1207 of the Revenue Act of 1926, c. 27, 44 Stat. 9, 129, reads as follows:

> The computation of invested capital for any taxable year under the Revenue Act of 1917, the Revenue Act of 1918, and the Revenue Act of 1921, shall be considered as having been correctly made, so far as relating to the inclusion in invested capital for such

> year of income, war-profits, or excess-profits taxes for the preceding year, if made in accordance with the regulations in force in respect of such taxable year applicable to the relationship between invested capital of one year and taxes for the preceding year.

In the report of the Conference Committee (House Report No. 356, 69th Congress, 1st Session, p. 59) the following statement was made with reference to this section:

> This amendment validates the regulations of the Internal Revenue Bureau applicable to the revenue acts of 1917, 1918, and 1921 in so far as such regulations apply to the relationship between invested capital of one year and taxes for the preceding year; * * *.

U. S. GOVERNMENT PRINTING OFFICE: 1930

# SUPREME COURT OF THE UNITED STATES.

No. 40.—October Term, 1930.

Faweus Machine Company, Petitioner,
*vs.*
The United States.
} On Writ of Certiorari to the Court of Claims.

[January 5, 1931.]

Mr. Justice Roberts delivered the opinion of the Court.

Certiorari was granted to the Court of Claims to review a judgment in favor of the United States in an action to recover an alleged overpayment of excess profits tax for the calendar year 1919. The petitioner, a corporation, kept its books and made its returns of income and excess profits taxes on the accrual basis. In its return for the year ended December 31, 1919, it did not deduct from invested capital any amount on account of income and excess profits taxes for 1918 assessed and paid in 1919.

The Commissioner of Internal Revenue determined that the invested capital for 1919 should be reduced by the amount of income and profits taxes for 1918, as of the dates in 1919 when the instalments of taxes fell due and were paid. To accomplish this he computed an average deduction for the year 1919, and diminished the earned surplus as of January 1, 1919, by subtracting from it the amount so ascertained.

The Commissioner's action was in accordance with Article 845 of Treasury Regulations 45, promulgated April 17, 1919, applicable to the Revenue Act of 1918. The pertinent portion follows:

> "federal income . . . taxes are deemed to have been paid out of the net income of the taxable year for which they are levied."

Section 326 (a) of the Revenue Act of 1918 provided that "as used in this title the term 'invested capital' for any year means . . . :

(1) Actual cash bona fide paid in for stock or shares;
(2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, . . . ;

(3) Paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year;"

Petitioner asserts that Article 845 was based on the erroneous assumption that income taxes are payable out of the net income of the taxable year for which they are levied.

The United States replies that it is, and since 1914 it has been, required that a taxpayer shall keep his books and make his returns on a basis which will reflect true income; that while the taxes for any year are not payable until the following year, good accounting practice requires an accrual of them as a liability of the current year's business; and that the regulation in question was not only reasonable, but necessary for proper administration of the Revenue Act.

The position of the Government is sound. A corporation cannot claim to have accumulated any net income in any year until provision is made for taxes accrued, based on net income for the same year.

The reasonableness of the regulation is further shown by the fact that "invested capital" was merely a legislative definition of an element in the formula prescribed for computation of excess profits tax. Congress might have expressly declared that taxes should be excluded from invested capital. It did not do so in § 326 (a), or elsewhere in the act. The regulations were made pursuant to express authority (see § 1309 of the Revenue Act of 1918). They are valid unless unreasonable or inconsistent with the statute. *United States* v. *Grimaud*, 220 U. S. 506, 517-518; *International Ry. Co.* v. *Davidson*, 257 U. S. 506, 514. They constitute contemporaneous construction by those charged with the administration of the act, are for that reason entitled to respectful consideration, and will not be overruled except for weighty reasons. *United States* v. *Moore*, 95 U. S. 760, 763; *Brewster* v. *Gage*, 280 U. S. 327, 336.

Petitioner insists that Article 845 is unreasonable as applied to 1918 taxes; that no one could know what those taxes would be at the close of the year, because the so-called Revenue Act of 1918 was not passed until February, 1919, and made changes in the rates. But the 1917 act was in force, and required the payment of the same sort of taxes, and petitioner concedes it accrued its taxes for 1918 and set them up in a reserve at the end of the year.

The Act of 1918 was retroactive and replaced the prior act of October 3, 1917, and taxpayers understood that the policy of the United States with respect to income and profits tax was continuous. In February, 1919, the Treasury promulgated Decision 2791, applicable to the 1917 Act, and in substance the same as Article 845, which was issued under the 1918 Act on April 17, 1919. The taxes in question were provided for by an act passed in February, 1919, but they were for the year 1918. The act was passed in ample time to allow the taxpayer to readjust its accounts for that year by including these taxes; and, since its books were kept on an accrual basis, it was necessary that this should be done in order clearly to reflect the income for 1918.

*United States* v. *Woodward*, 256 U. S. 632, on which petitioner relies, is clearly distinguishable on the grounds stated in *United States* v. *Anderson*, 269 U. S. 422, 441.

We cannot hold that the regulation on which the Commissioner relied was unreasonable or in conflict with the provisions of the statute. The judgment is affirmed.

A true copy.

Test:

*Clerk, Supreme Court, U. S.*